AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

THE PRIVATE SECTOR AND GOVERNMENT RESPONSE TO THE MORTGAGE FORECLOSURE CRISIS

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

DECEMBER 8, 2009

Printed for the use of the Committee on Financial Services

Serial No. 111–93

U.S. GOVERNMENT PRINTING OFFICE

56–236 PDF WASHINGTON : 2010

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

HOUSE COMMITTEE ON FINANCIAL SERVICES

BARNEY FRANK, Massachusetts, *Chairman*

PAUL E. KANJORSKI, Pennsylvania
MAXINE WATERS, California
CAROLYN B. MALONEY, New York
LUIS V. GUTIERREZ, Illinois
NYDIA M. VELÁZQUEZ, New York
MELVIN L. WATT, North Carolina
GARY L. ACKERMAN, New York
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
DENNIS MOORE, Kansas
MICHAEL E. CAPUANO, Massachusetts
RUBÉN HINOJOSA, Texas
WM. LACY CLAY, Missouri
CAROLYN McCARTHY, New York
JOE BACA, California
STEPHEN F. LYNCH, Massachusetts
BRAD MILLER, North Carolina
DAVID SCOTT, Georgia
AL GREEN, Texas
EMANUEL CLEAVER, Missouri
MELISSA L. BEAN, Illinois
GWEN MOORE, Wisconsin
PAUL W. HODES, New Hampshire
KEITH ELLISON, Minnesota
RON KLEIN, Florida
CHARLES A. WILSON, Ohio
ED PERLMUTTER, Colorado
JOE DONNELLY, Indiana
BILL FOSTER, Illinois
ANDRÉ CARSON, Indiana
JACKIE SPEIER, California
TRAVIS CHILDERS, Mississippi
WALT MINNICK, Idaho
JOHN ADLER, New Jersey
MARY JO KILROY, Ohio
STEVE DRIEHAUS, Ohio
SUZANNE KOSMAS, Florida
ALAN GRAYSON, Florida
JIM HIMES, Connecticut
GARY PETERS, Michigan
DAN MAFFEI, New York

SPENCER BACHUS, Alabama
MICHAEL N. CASTLE, Delaware
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
RON PAUL, Texas
DONALD A. MANZULLO, Illinois
WALTER B. JONES, JR., North Carolina
JUDY BIGGERT, Illinois
GARY G. MILLER, California
SHELLEY MOORE CAPITO, West Virginia
JEB HENSARLING, Texas
SCOTT GARRETT, New Jersey
J. GRESHAM BARRETT, South Carolina
JIM GERLACH, Pennsylvania
RANDY NEUGEBAUER, Texas
TOM PRICE, Georgia
PATRICK T. McHENRY, North Carolina
JOHN CAMPBELL, California
ADAM PUTNAM, Florida
MICHELE BACHMANN, Minnesota
KENNY MARCHANT, Texas
THADDEUS G. McCOTTER, Michigan
KEVIN McCARTHY, California
BILL POSEY, Florida
LYNN JENKINS, Kansas
CHRISTOPHER LEE, New York
ERIK PAULSEN, Minnesota
LEONARD LANCE, New Jersey

JEANNE M. ROSLANOWICK, *Staff Director and Chief Counsel*

CONTENTS

	Page
Hearing held on:	
December 9, 2009	1
Appendix:	
December 9, 2009	53

WITNESSES

THURSDAY, SEPTEMBER 00, 2009

Allison, Herbert M., Jr., Assistant Secretary for Financial Stability, U.S. Department of the Treasury	35
Goodman, Laurie S., Senior Managing Director, Amherst Securities	13
Gordon, Julia, Senior Policy Counsel, Center for Responsible Lending	9
Krimminger, Michael H., Special Advisor for Policy, Office of the Chairman, Federal Deposit Insurance Corporation (FDIC)	37
Marks, Bruce, Chief Executive Officer and Founder, Neighborhood Assistance Corporation of America (NACA)	14
Roeder, Douglas W., Senior Deputy Comptroller for Large Bank Supervision, Office of the Comptroller of the Currency (OCC)	39
Sanders, Anthony B., Distinguished Professor of Real Estate Finance, Professor of Finance, School of Management, George Mason University	11
Schakett, Jack, Credit Loss Mitigation Strategies Executive, Bank of America	7
Sheehan, Molly, Senior Vice President, Chase Home Finance	6

APPENDIX

Prepared statements:	
Carson, Hon. Andre	54
Marchant, Hon. Kenny	56
Allison, Herbert M., Jr.	58
Goodman, Laurie S.	68
Gordon, Julia	73
Krimminger, Michael H.	95
Marks, Bruce	115
Roeder, Douglas W.	119
Sanders, Anthony B.	136
Schakett, Jack	140
Sheehan, Molly	146

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Capito, Hon. Shelley Moore:	
Written statement of the HOPE NOW Alliance	156
Allison, Hon. Herbert M., Jr.:	
Written responses to questions submitted by Representatives Adler and Baca	162
Gordon, Julia:	
Written responses to questions submitted by Representatives Adler and Baca	165
Krimminger, Michael H.:	
Written responses to questions submitted by Representatives Adler and Baca	167

Page

Roeder, Douglas W.:
Written responses to questions submitted by Representatives Adler and Baca 170
Sheehan, Molly:
Written responses to questions submitted by Representatives Adler and Baca 173

THE PRIVATE SECTOR AND GOVERNMENT RESPONSE TO THE MORTGAGE FORECLOSURE CRISIS

Tuesday, December 8, 2009

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:08 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Waters, Maloney, Watt, Moore of Kansas, Clay, Baca, Lynch, Miller of North Carolina, Scott, Green, Cleaver, Klein, Donnelly, Carson, Kosmas, Himes, Peters; Royce, Capito, Hensarling, Neugebauer, Marchant, Jenkins, and Paulsen.

The CHAIRMAN. Good morning. I apologize for the delay, but with the major legislative product of this committee coming up, we are a little busy. We will convene this hearing today. We have had a series of conversations obviously on an ongoing basis with a variety of people.

We have a great frustration at the failure of the combined efforts of elements of the Federal Government to make a substantial impact on the foreclosure issue. Programs have been put forward and revised, but no one can think we have done a satisfactory job. Part of it is mistakes of the past, and one of the things we are determined to do going forward—the gentlewoman from California, Ms. Waters and others have talked about this—is to change the law so that some of the problems we now have will not continue. Namely, we will not have situations where there are mortgages that we believe it is in the public interest to modify and no one has the authority to modify it, or at least if someone has the authority to modify it, he or she is able to dodge the responsibility by invoking some shared responsibility. That cannot be allowed to continue.

So we will straighten that out going forward, but we are in a current situation with a tangle of problems. Many of us feel that bankruptcy for primary residences is ultimately going to be necessary to get a substantial improvement. Those who disagree with that have a particular burden in my mind of showing that it is possible to achieve substantial avoidance of foreclosure, with all the negative consequences that has for the society, without it.

And I do want to stress that when we talk about mortgage foreclosure avoidance, we're not simply talking about compassion for individuals. Many of the individuals involved are the victims of cir-

cumstance. Many were misled. Some were themselves less than responsible. But the problem is, even if people want to say, okay, they made their bad mortgage decision, let them live with it, that has reverberating consequences for the whole society.

Foreclosures create concentric circles of harm, primarily to the individual family, but then to the neighborhood, to the municipality, and to the whole economy because of the widespread dispersion of mortgage-backed securities. So slowing down the rate of foreclosures is very important.

We will in the bill before us this week be including a provision—I hope that it will be accepted—that will deal with a new class of foreclosure, a relatively new class, those who took out mortgages that were not themselves problematic but who are unemployed and find that you cannot make mortgage payments out of unemployment compensation if that's your sole source of income. We will be putting forward a program modeled on a successful one in Philadelphia that will lend money to those who are unemployed and face loss of their homes for the duration of their unemployment or some other period. That will help some. But we still have the problem of those mortgages that have to be disentangled. And as I said, we are dissatisfied with the progress, and what we are doing again today, we hope, is to get specific proposals that will help us further disentangle this situation.

So with that, I'm going to recognize the ranking member of the Housing Subcommittee, and we have a total of 10 minutes on each side, and we will proceed from there. The gentlewoman from West Virginia.

Mrs. CAPITO. Thank you, Mr. Chairman. I would like to thank you for holding this hearing this morning, and I too share the chairman's frustration. And he and I are both well aware, as we had a similar meeting in the Housing and Community Opportunity Subcommittee in September of this year on the very issue of tracking progress with the Administration's foreclosure mitigation program.

Introduced in early 2009, the Making Home Affordable Program was rolled out with the promise of assisting seven to nine million troubled borrowers, yet the program has thus far assisted only a small fraction of that estimate. While the Administration's plan was somewhat more successful than the troubled HOPE for Homeowners program, I have significant concerns with the overestimation of the population served by these programs. Although there are many Americans who are struggling to pay their mortgages, it has become clear that these programs simply may not be capable of handling the volume of borrowers, nor is it realistic to suggest that every struggling borrower will be able to benefit from a modification.

Furthermore, there should not be a push to achieve these targets at the expense of ensuring that modifications are being processed in a manner that ensures the lender has as complete a picture of the borrower's financial situation as possible. To this end, I was very troubled to learn that some modifications are being performed with minimal documentation. After all, it was this very practice of no- or low-documentation loans that helped create the housing cri-

sis we face today. We should not be in the business of perpetuating this practice.

According to the Treasury Department, 375,000 trial modifications are set to convert to permanent modification by the end of the year. However, JPMorgan Chase recently disclosed that in November, close to 25 percent of the trial modifications failed to make the first payment, and nearly 50 percent of borrowers failed to make all 3 payments. Furthermore, the Federal Reserve Bank of Boston cites that 30 to 45 percent of borrowers who receive modifications end up in default within 6 months. This raises significant concerns about the ability of these programs to meet the long-term expectations outlined earlier this year.

These challenges are greatly compromised by a shift in the root causes of foreclosures. With the downturn in the economy, as the chairman mentioned, we are now facing more traditional causes of foreclosure, namely the loss of a job. As these programs progress, we must have a realistic understanding of their capability, and we have an obligation to our taxpayers to focus our efforts first and foremost on families who truly need assistance.

I look forward to hearing from our witnesses this morning, and I again want to thank the chairman for holding this important hearing.

Mr. WATT. [presiding] The gentlelady yields back, and the gentleman from Georgia, Mr. Scott, is recognized for 2 minutes.

Mr. SCOTT. Thank you very much, Mr. Chairman. I can't think of a more pressing issue for us to deal with at this time than the foreclosure situation. It is alarming. RealtyTrac, for example, reports that in the third quarter of 2009, my State of Georgia had a 25 percent increase in home foreclosures over the third quarter in 2008. That is a total of over 36,000 foreclosure filings, or 1 in every 98 households. That is absolutely devastating.

But I want to turn just for a moment about what is an even more devastating situation, perhaps the most insidious side of our current foreclosure crisis and loan modification process, and that is the unfortunate scamming of vulnerable homeowners who are in desperate need of assistance in saving their homes. It is one of the most tragic aspects of human existence, in my opinion, that whenever and wherever people are downtrodden, others will move in and prey upon them and worsen their condition.

I was just contacted last night by a constituent who had contracted with a group called Prodigy Law Group in Irvine, California, just to help him to navigate the loan modification process. They contacted him and said they could bring it down far better than anyone else. And unfortunately what my constituent did not know was that this firm had a reputation as being scam artists. In fact, the Better Business Bureau of California as well as numerous other outfits had identified the Prodigy Law Group as known scammers.

So as we debate this issue, not only must we deal with what is before us and what we're doing, but we have to find a way to put these predatory beasts that are preying on people who are already in bad conditions out of business.

I yield back the balance of my time.

Mr. WATT. The gentleman yields back. Mr. Hensarling is recognized, it says for 3 minutes, but actually you have a little bit more than that. I'm not sure exactly how much time is left, 3½ minutes, I think.

Mr. HENSARLING. Thank you, Mr. Chairman. By any standard of measurement, the foreclosure mitigation programs of this Administration and this Congress have been abject failures. HOPE for Homeowners had $300 billion authorized at least as of summer, the latest date I have available, 1,000 applications, and 50 loans closed by July. The Home Affordable Modification Program, $75 billion cost, supposed to help 3 to 4 million homeowners, 650,000 modifications, trial modifications.

The Home Affordable Refinance Program, supposed to help 4 to 5 million homeowners, latest numbers available, 116,500. Yet we know that foreclosure rates and delinquency rates continue to rise from 9.9 percent in the third quarter of 2008 to now 14.1 percent in the third quarter of 2009. Government taxpayer-funded foreclosure mitigation programs have been an abject failure. On the other hand, those who actually hold loans have a financial incentive for borrowers who can work out to make modifications. And under the HOPE NOW Program, at least as of the latest data available, 4.7 million have been afforded workout plans since August of 2007 with no cost to the taxpayer.

Now there is no better foreclosure mitigation plan than a job. And unfortunately, the job creation program of this Administration has also been an abject failure, as we suffer through the highest unemployment rate that we have had in a generation, 3½ million of our fellow countrymen having lost their jobs since the President took office.

The best way to have a foreclosure mitigation plan, again, is to create a job. And the best way to create a job is to tell job creators that they're not going to have to contend with a trillion dollar nationalized takeover of a health care system, that a $600 billion threatened energy tax to our economy will not take place, that the tax relief in this decade that brought upon one of the longest periods of economic prosperity will not be allowed to expire so that tax rates on income, on dividends, on capital gains increase, that some certainty will be brought to the market, and the bill that Chairman Frank will bring to the Floor tomorrow, which will be a job-crushing bailout bill, whether that too would not become law.

That is a plan. That is a recipe to create jobs in our economy, to take away the looming storm clouds of Obamanomics and let this economy create jobs. And if you create jobs, then people can keep their homes. Nothing short of that will work. We have to signal to those who ultimately have to pay the bill that this is a Congress and this is an Administration ultimately that is going to be serious about the debt and the deficit. Throwing more money at programs that do not work is absolutely insane, and it does not work. Why we would be considering giving more money to the same programs is beyond me.

I yield back the balance of my time.

Mr. WATT. The gentleman's time has expired, and I will recognize myself for 2 minutes, and then I will go to Mr. Klein as our final opening statement.

Let me just say that it is obvious that we have a serious foreclosure problem, default problem, and that has come home to all of us with the nature of the calls that have come into our offices. Generally, before this economic meltdown, our job was to intervene with the Federal Government on behalf of constituents to get Social Security checks or VA benefits or travel documents. The bulk of the business that we are now doing is calls from people trying to get credit or trying to get out from under or survive the credit that they were already extended. Disproportionately, our calls are that.

And I got an even greater appreciation for that this past weekend when Mr. Marks' group, the Neighborhood Assistance Corporation of America, brought their road show to my congressional district in Charlotte and well over 50,000 people showed up from all over the country seeking to have their loans modified. We are in a serious problem, and the programs that are out there, even when they are working, are not working on a scale that's large enough to have the impact that needs to be had. And then on top of that, the loss of jobs has added a whole other wave of foreclosures and defaults that has made the problem worse.

So I welcome this opportunity to hear from the witnesses today. My time has expired, and I will now recognize the gentleman from Florida, Mr. Klein, for 2 minutes.

Mr. KLEIN. Thank you, Mr. Chairman, and thank you for holding this important hearing. I'm from South Florida, and we face serious problems with our housing market, as many other parts of the country do. And I think we all understand it's essential for both banks and servicers as well as the Federal Government to implement effective programs to increase loan modification and prevent foreclosures where they can be prevented.

I'm pleased to see the increased focus on foreclosure prevention from the Obama Administration, and they have taken some steps in the right direction, but we have a long way to go. One of the problems with the Home Affordable Modification Program and other initiatives is incomplete paperwork, and we hear this over and over again. Documents are submitted for the loan modification, and we just keep hearing that it's not the right documents, and then from the borrower's side, we hear that they have been asked over and over to present the same documents. It's a communication problem, it's a dragging of the feet problem, and in some cases, it's a problem of the servicers and banks not having adequate personnel, quantity and quality, to service these loan modifications and to address the problems.

I'm also concerned about the process of short sales, and I appreciate the new Treasury guidelines that have come into play to expedite the closings on short sales. Yet I still have concerns they don't go far enough to address some of the issues complicating the execution of short sales, particularly secondary liens and investor interest, which my attitude is, where there's a will, there's a way. I think these are things that can be worked through.

Another issue is appraisals. This seems to be a constant issue in terms of working through difficulties in loan modifications, because some properties were overvalued on the way up and because there's very little activity at the ground level right now, appraisals are coming in exceedingly low and not necessarily reflective of the

value. Again, I think this is something that's deepening the problem and prolonging the agony.

Lastly, I want to point out that in many cases, banks are also sitting on foreclosure proceedings, so they don't have to necessarily write down the asset or take title and step in the shoes of the borrower, and that's creating another problem in the communities because people who aren't keeping up with their mortgages are not keeping up with their taxes and not keeping up with their homeowners assessments and condominium assessments, and it's creating a whole problem in terms of the marketability of properties in those communities and the value in those properties.

So I just want to say that we have a lot of work to do. I appreciate everybody coming here today, and giving us their thoughts and ideas, and we need to move expeditiously on this important issue.

I thank the chairman.

Mr. MOORE OF KANSAS. [presiding] The Chair recognizes Ms. Sheehan.

STATEMENT OF MOLLY SHEEHAN, SENIOR VICE PRESIDENT, CHASE HOME FINANCE

Ms. SHEEHAN. Good morning. My name is Molly Sheehan. I work for the Home Lending Division of JPMorgan Chase as the executive responsible for housing policy. At Chase, we have been working very hard to help prevent foreclosures and keep families in their homes. Since 2007, under our expansive programs, we have helped prevent over 885,000 foreclosures.

Since January 1, 2009, Chase has offered over 568,000 modifications to struggling homeowners for a value of over $100 billion in mortgage loans. We have approved or completed over 112,000 permanent modifications under HAMP, Chase Proprietary Modification programs or other modification programs offered by the GSEs and FHA/VA. We have given specific details of all of that activity in our written testimony for you to review.

This year alone, we have opened 30 Chase Homeownership Centers in 13 States. Over 60,000 struggling borrowers around the country have been able to meet with trained counselors face-to-face. We plan to add an additional 21 sites early next year. We have added over 2,500 loan modification counselors in 2009, bringing the total number to 5,200 loan modification counselors in 15 sites around the country. We have hired over 2,800 additional mortgage operation employees to handle the unprecedented volume. So we now have nearly 14,000 home lending employees at Chase dedicated to helping our homeowners.

We have handled over 12.8 million inbound calls, and our outbound foreclosure prevention calls increased to 4 million in 2009, up from 400,000 the year earlier. And we have had 3.6 million visits to our dedicated Web site for loan modifications where borrowers have been able to download over 1.6 million modification packages that they can provide to Chase.

Through HAMP alone, we have offered trial plans to over 200,000 homeowners and are working very hard to make those modifications permanent. Based on our experience, for every 100 HAMP trial plans initiated from April through September 2009, 29

borrowers did not make all required payments under their trial plan, making them ineligible for a permanent modification under HAMP. Seventy-one borrowers made all three payments under their trial plans. Of those 71, 20 borrowers did not submit yet all the documents required for underwriting. Thirty-one customers have submitted all the required documents, but the documents do not yet meet HAMP underwriting standards. Twenty borrowers have completed all required documents and are eligible for underwriting. And out of those 20, 16 will likely be approved or have already been approved for a permanent HAMP modification.

To the extent a borrower is not approved for a permanent HAMP modification, we have other alternatives available to them under Chase modification programs and programs offered by the GSEs and FHA/VA. Right now, we are very focused on helping the 51 percent of borrowers who are paying but need help completing documents, and have implemented aggressive new initiatives: A coordinated program to call our customers 36 times; reach out by mail 15 times; and make at least 2 home visits, if necessary, to help complete documents. Also, ordering key documents earlier in the process so they're ready when the borrower's documents come in to expedite underwriting; targeting outreach efforts to borrowers who live near our Chase Homeownership Center so they can come in in person to get help completing their documents; and assigning specific pools of accounts to loan modification counselors to provide continuity in dealing with the customer and end processing.

Under this program recently launched, we have completed over 4 million calls, letters, and home visits, for an average of 27 activities per borrower through the end of November to help the conversion process to permanent.

We are also paying special attention to the 31 percent whose documents are in but don't meet HAMP requirements. And we will be working on very specific initiatives to get that process completed with the Treasury in order to simplify the documentation for our borrowers.

Thank you very much. I would be happy to answer any questions you have.

[The prepared statement of Ms. Sheehan can be found on page 146 of the appendix.]

Mr. MOORE OF KANSAS. Thank you, Ms. Sheehan.

The Chair next recognizes Mr. Jack Schakett, credit loss mitigation strategies executive, Bank of America. Sir, you have 5 minutes.

STATEMENT OF JACK SCHAKETT, CREDIT LOSS MITIGATION STRATEGIES EXECUTIVE, BANK OF AMERICA

Mr. SCHAKETT. Chairman Moore, Congresswoman Capito, and members of the committee, thank you for the opportunity to update you on Bank of America's loan modification efforts and to discuss areas where we can work together to help more homeowners stay in their homes.

I am Jack Schakett, Bank of America's credit loss mitigation executive, and I have the responsibility of foreclosure prevention programs with a mortgage servicing portfolio of more than 14 million. Bank of America is a proud partner in the Administration's Home

Affordable Modification Program, HAMP. With more than 160,000 customers currently active in trial modifications, HAMP has proven a valuable tool that complements the aggressive loan modification programs that Bank of America already has in place.

Over the last 2 years, Bank of America, with the combined effort of HAMP, has offered help to 615,000 homeowners. In over 100,000 calls a day, we hear from our customers, their concerns and their frustrations. We believe we have improved significantly our ability to handle the large volume associated with these calls, but we also believe much more needs to be done.

We fully share Treasury's commitment to convert successful trial modifications to permanent as quickly as possible. In support of that commitment, Bank of America is focusing on assisting customers and providing all the necessary documents for the underwriting process. Otherwise, homeowners are at risk of missing this opportunity to obtain a HAMP loan modification, an outcome that none of us want.

As this committee knows from prior hearings, in addition to the customers making three timely trial payments, the servicer must fully underwrite the permanent modification. This includes verifying income, occupancy status, and tax returns. Specifically, Bank of America has approximately 65,000 customers who have made more than 3 trial payments on time. These modifications are set to expire on December 31st. Of those customers, 50,000 have either not submitted some or all the required documents or the documents they have submitted revealed a discrepancy that needs to be followed up on with the customer.

For these customers, Bank of America last week sent by overnight mail an urgent request for the documents needed to be complete in the process and set up the timeframes required to avoid losing the Treasury's modification program benefits. We included a return, prepaid express mail envelope to make the process as easy as possible. This is in addition to the previous reminder calls and mailing attempts.

We have dedicated substantial resources to these efforts, including the expansion of our default management staff to nearly 13,000. For all the customers who have now submitted their documentation, we are confident that we can meet the Treasury's requirement to fully underwrite 100 percent of these loans before the trial expiration.

But despite these efforts, it was clear that some portion of these customers who are facing a December 31st expiration would not be able to complete the process and would narrowly miss the deadline. Late yesterday, after a meeting with the Treasury Department, where we discussed our concerns about the looming expiration date, Treasury released new guidance that will prove to be very helpful in relief to the customers who have submitted all their documents and where servicers are still working on completing the underwriting or the notarization process. We think this new guidance will go a long way to eliminate fallout on technical grounds, and we really appreciate the assistance from the Treasury Department.

Today, I would also like to offer several areas for consideration where HAMP could be enhanced to help more customers. Based on the Treasury survey data, the total customers eligible today for as-

sistance of the program is estimated to be 1.5 million. Bank of America's share of that is about 340,000. Bank of America has made offers to 74 percent of that population and has started trial modifications with nearly half. This compares favorably to the latest Treasury report for all servicers participating in the program.

We believe this demonstrates that HAMP is an effective program in reaching certain borrowers. However, the program was not designed to assist borrowers who have vacated their homes or no longer occupy their home as their principal residence. Nor was the program structured to assist for the unemployed or those already with a relatively affordable housing payment of less than 31 percent of their income.

We encourage Treasury to expand HAMP to assist in meeting some of these challenges, specifically including a program for the unemployed and allowances for a housing ratio less than 31 percent for the low- to moderate-income borrowers. In any case, Bank of America will continue to provide solutions to these customers that fall outside the reach of HAMP.

At Bank of America, our goal is to keep as many customers in their homes as possible. We understand the urgency of all solutions, not only for the customers we serve, but to further encourage the housing recovery that has begun to take root. We appreciate the continued strong support and partnership with the Administration and Congress on this very important issue.

Thank you.

[The prepared statement of Mr. Schakett can be found on page 140 of the appendix.]

Mr. MOORE OF KANSAS. Thank you very much.

We next recognize for testimony Ms. Julia Gordon, senior policy counsel for the Center for Responsible Lending. Ms. Gordon, you have 5 minutes.

STATEMENT OF JULIA GORDON, SENIOR POLICY COUNSEL, CENTER FOR RESPONSIBLE LENDING

Ms. GORDON. Good morning, Chairman Moore, Ranking Member Capito, and members of the committee. Thank you for inviting me today to talk about stopping foreclosures.

Without stronger policy intervention, not only will millions of families lose their homes unnecessarily, but foreclosures will continue to destroy communities, especially minority communities, hamper the housing market, and slow or prevent a full economic recovery. I serve as senior policy counsel at the Center for Responsible Lending, a nonpartisan research and policy organization dedicated to protecting homeownership and family wealth.

We are affiliates of Self-Help, a nonprofit financial institution that makes mortgage loans in lower-income neighborhoods, and is consequently grappling with many of the same issues encountered by other lenders. And my testimony is informed by this experience. The government's principal anti-foreclosure program, HAMP, has not reached its potential. One obstacle impeding HAMP's success is that the private servicing industry as a whole is either unable or unwilling to do what it has agreed to do. To address this problem, Congress should mandate loss mitigation prior to foreclosure.

For many servicers, only a legal requirement will cause them to build the systems and safeguards necessary to ensure that such evaluations occur before the home is lost. One relatively simple way to improve the HAMP program would be for Treasury to require servicers to stop all foreclosure proceedings while borrowers are being evaluated for a HAMP modification. Right now, foreclosures may proceed up to the point of sale on a parallel track with the loss mitigation discussions. As a result, homeowners receive a confusing mix of communications from their lender, some of which tell the borrower they're being considered for a modification, but others of which warn of an impending foreclosure.

Confused borrowers who think they're going to lose their homes may fail to send in their documentation, may default early on a trial modification, may not answer the phone when their servicer calls, or they may leave the home, which makes them ineligible for HAMP. It's also crucial for Treasury to make the NPV model public, so that homeowners can tell whether their HAMP evaluation was done correctly, and for Treasury to provide full public access to the HAMP database to encourage evidence-based program creation and ideas, similar to the way we get full data under the "Home Mortgage Disclosure Act."

Only that data will be able to tell us what works and what doesn't, what servicers are doing the best job, and whether minority homeowners are being helped to the same degree as White homeowners. The foreclosure problem also has evolved, and we must expand HAMP to meet new challenges, such as negative equity and unemployment. Others on this panel will talk more about the importance of principal reduction, something we believe would be enormously useful under this program, and we also should expand HAMP to assist homeowners who have lost their jobs and may not have the 9 months of guaranteed unemployment income that they need to be eligible for HAMP. And this is what would be done through Chairman Frank's TARP for Main Street bill.

Beyond the HAMP program, we urge Congress to lift the ban on judicial modifications of principal residence mortgages. This solution costs nothing to the U.S. taxpayer. It's the only solution that cuts through the Gordian Knot of second liens, securitization, negative equity, and back-end consumer debt. It would also serve as a stick to the carrot of HAMP incentive payments.

Finally, we commend this committee for its work on legislation to create the Consumer Financial Protection Agency and we urge the full House to pass that bill this week. We now know it's much less expensive and much easier to prevent these problems than to clean up after them. The CFPA would gather in one place the consumer protection authority which is currently scattered across many different agencies, and it would remain fully focused on the sole mission of protecting our families and economy from the dire consequences of predatory lending and consumer abuse.

Thank you for inviting me today, and I look forward to your questions.

[The prepared statement of Ms. Gordon can be found on page 73 of the appendix.]

Mr. MOORE OF KANSAS. Thank you for your testimony, Ms. Gordon.

Next is Dr. Anthony B. Sanders, distinguished professor of real estate finance, professor of finance, School of Management at George Mason University.

Sir, you are recognized for 5 minutes.

STATEMENT OF ANTHONY B. SANDERS, DISTINGUISHED PROFESSOR OF REAL ESTATE FINANCE, PROFESSOR OF FINANCE, SCHOOL OF MANAGEMENT, GEORGE MASON UNIVERSITY

Mr. SANDERS. Mr. Chairman and members of the committee, thank you for the invitation to testify before you today.

According to the Treasury Service Performance Report through October of 2009, 920,000 trial modification plans have been offered to borrowers, and 651,000 trial modifications have been made. Given the fall off the cliff of housing prices in many States, the surge of unemployment, and the evaporation of liquidity for banks and related institutions in the second half of 2007, I am frankly surprised that the servicing industry has moved so quickly to make loan modifications in such large numbers.

With 14.4 percent of borrowers in foreclosure or delinquent on their mortgages, this creates an incredible challenge to the servicing industry. It is a real challenge to servicers to make loan modifications succeed when 70 percent of loan modifications that have only interest rate cuts have gone into default, redefault after 12 months. If the loan modification affordability calculation is done, or HAMP only uses first lien mortgages, the failure of these modifications is not unanticipated. And as I mentioned in the House TARP hearings during November 2008, the negative equity problem in the sand States of California, Arizona, Nevada, and Florida is going to be very, very challenging for the servicing industry.

Loan modifications must take into account consideration for the negative equity position of households to determine the likelihood of success in making these payments. Why are so few loans expected to be permanent? Well, there are several reasons for this. The first reason for the projected failure rate is the degree to which many residential loans in the United States are in a negative equity situation. According to a Deutsche Bank research report, they are expecting 25 million homes to be in negative equity position.

The second reason is the unemployment rate. While a 10 percent unemployment rate is bad enough, the true unemployment rate, including wage and salary curtailment, is closer to 17½ percent. This is a very challenging obstacle to overcome for the servicing industry.

The third is the documentation problem, which we have heard about today. To qualify for a trial loan modification, the HAMP program is following the stated income approach that does not require documentation. Like stated income loans, qualification for temporary loan modifications is fertile ground for moral hazard problems, where borrowers/applicants who are insulated from risks may behave differently from the way they would if they were fully exposed to the risk. In this case, borrowers may not want to submit the required documentation, since they may be denied for permanent modification. This is not to say that some borrowers have not experienced true documentation problems, which would be con-

sistent with the dramatic growth in demand for loan modifications through HAMP as servicing entities ramp up their servicing efforts to meet the demand.

The fourth reason is that many borrowers are having trouble making the three consecutive payments, because they either have too much income, not enough income, or a house that has fallen too much in value. The Making Home Affordable Program provides a service performance report that rank orders the servicers in terms of active trial modifications, a share of eligible 60-plus days delinquencies, the higher the better.

The problem with this accounting for success, is it does not control for servicers who are servicing loans in particularly hard areas, such as bubble States like California, Arizona, Nevada, and Florida. Servicers in these States where housing prices have collapsed by as much as 50 percent in some areas are going to be heavily challenged to perform these modifications. When you add in the already high unemployment rates in these States, these are indeed great challenges. In addition, the highest unemployment rates by metropolitan area as of September are: Detroit, 18½ percent; Warren, a suburb, 17 percent; Riverside, 14.1 percent; Las Vegas, 13.7 percent; and L.A., 12.7 percent.

While Arizona has only an unemployment rate of 9.1 percent, the difficulty of modifications must be considered when combined with the crash of the housing crises that have occurred there. The States and metropolitan areas with the highest unemployment rates should be taken into consideration when determining the loan modification success rates.

My recommendation is for Treasury to account for loans that are serviced in the bubble States and the Midwest economically malaised States, such as Ohio and Michigan. In short, modifying loans in Nebraska is likely to be far easier than modifying loans in Arizona, Nevada, and the Inland Empire. One thing we should consider is allowing financial institutions, rather than taking immediate hits to their capital when we have a modification or default, allowing them to amortize their losses over a 5-year period. That would enable sales of some of these distressed assets as TARP was originally intended to do and allow other participants to jump into the market to do more innovative programs like short payoffs, short sales foreclosures, conversions to leases, which Fannie Mae is considering, and broader loan modifications that make particular sense. Particularly given the vacancy rates in many States in the housing market, conversions at least make some sense when the comparatively low rental rates compare to mortgage payments.

I appreciate the opportunity to speak with you.

[The prepared statement of Dr. Sanders may be found on page 136 of the appendix.]

Mr. MOORE OF KANSAS. Thank you, sir. The Chair appreciates your testimony.

And next, the Chair recognizes Ms. Goodman for 5 minutes. Ms. Goodman is the senior managing director for Amherst Securities.

You are recognized, ma'am.

STATEMENT OF LAURIE S. GOODMAN, SENIOR MANAGING DIRECTOR, AMHERST SECURITIES

Ms. GOODMAN. Mr. Chairman and members of the committee, I am honored to testify today. My name is Laurie Goodman and I am a senior managing director at Amherst Securities, a leading broker-dealer specializing in the trading of residential mortgage-backed securities.

I am in charge of strategy and business development. To keep abreast of trends in the residential, mortgage-backed securities market, we do an extensive amount of data-intensive research. I will share some of our results with you today.

As a result of my testimony, I hope to leave you with two points. First, the housing market is fundamentally in very bad shape. The largest single problem is negative equity. Second, the current modification program does not address negative equity and is therefore destined to fail. There is no single solution to this crisis. The arsenal of measures must include principal reduction and must explicitly address the loss allocation between first lien investors and second lien investors.

In order to place today's topic into context, let's look closely at the housing market. The mortgage bankers delinquency survey for Q3 shows that 14.1 percent of borrowers are not making their mortgage payments. That is 7.9 million homeowners. This dramatic increase from several years ago is the result of three things: first, borrowers are transitioning into delinquency at a rapid rate; second, cure rates are extremely low; and third, the time between when a borrower first goes delinquent and when the home is liquidated has lengthened dramatically.

Given the current trajectory, we estimate that approximately 7 million of these 7.9 million homeowners will be forced into vacating their properties. This estimate of 7 million units includes only the borrowers who have already stopped making their mortgage payments. It does not include the 250,000 new borrowers per month who are going delinquent for the first time. Modifications can't help considerably as their success rate has been low.

The real problem is that many borrowers have negative equity in their home. Most borrowers don't default because of negative equity alone. Generally, a borrower experiences a change in financial circumstances, misses a payment on their mortgage, and then re-evaluates their financial priorities. If the home has substantial negative equity, they will choose to walk. A few numbers will help illustrate this point. At Amherst, we did a study looking at all prime borrowers who were 30 days delinquent on their mortgage 6 months ago. Six months later, we found for prime borrowers with 20 percent equity, only 38 percent had become 60-plus days delinquent. For prime borrowers with substantial negative equity, 75 percent had become 60-plus days delinquent.

There is a substantial group of people who have argued that the primary problem is not negative equity, it is unemployment. This is not supported by the evidence. First, the increase in delinquencies for subprime, Alt-A, and pay option ARM mortgages began to accelerate in Q2 2007. By contrast, we did not begin to see large increases in unemployment until Q3 2008.

Further evidence of the importance of negative equity comes from another study we recently completed. We found that the combined loan to value ratio, or CLTV, plays a critical role. For Alt-A and prime loans in low unemployment areas, the default frequency was at least 4 times greater for borrowers underwater by 20 percent than it was for borrowers with at least a 20 percent equity position. We also found that if a borrower has positive equity, unemployment plays a negligible role. All borrowers with positive equity perform similarly, no matter what the local level of unemployment. Indeed, negative equity is the most important predictor of default. When the borrower has negative equity, unemployment acts as one of many possible catalysts greatly increasing the probability of default.

HAMP modifications, as you are aware, are primarily a payment reduction plan. HAMP has three fatal flaws. First, the agent retained to make the modification was a mortgage servicer rather than an originator. Second, HAMP only considers the first mortgage payment, taxes, and insurance. It does not consider the borrower's total financial circumstances. Third and most importantly, the program does not emphasize the re-equification of the borrower.

What can/should be done? Here are some imperatives. First, there is no "one-size-fits-all" approach to modifications. Second, moving principal reduction higher in the HAMP modification waterfall would be the most natural way to raise the success of the modification program. Would investors support this type of program? Absolutely. While foreclosure is devastating to a borrower, it's also devastating to an investor, because recovery rates are low. The interest of the first lien investor and the borrower are totally aligned.

Third, any principal reduction program requires the Administration to address the second lien problem head on. Fourth, we endorse the revamped HOPE for Homeowners Program. Fifth, we need more transparency on the data.

We are concerned that if policies continue to kick the can down the road, working with a modification program that does not address negative equity, delinquencies will continue to spiral with no end in sight.

Thank you very much for allowing me to testify today. I am happy to answer any questions. It has been an honor.

[The prepared statement of Ms. Goodman can be found on page 68 of the appendix.]

Mr. MOORE OF KANSAS. Thank you, Ms. Goodman, for your testimony.

And finally, the Chair recognizes Mr. Bruce Marks from Neighborhood Assistance Corporation of America.

Sir, you have 5 minutes.

STATEMENT OF BRUCE MARKS, CHIEF EXECUTIVE OFFICER AND FOUNDER, NEIGHBORHOOD ASSISTANCE CORPORATION OF AMERICA (NACA)

Mr. MARKS. Thank you very much. It is very good to be here. My name is Bruce Marks and I am CEO and founder of NACA, the

Neighborhood Assistance Corporation of America. We are a nonprofit homeownership advocacy organization.

I am not going to read from the prepared remarks that we have done, because I think we have an interesting panel. So I want to respond to some of the points that were made in the panel.

One thing I wanted to go through is we have legally binding agreements with every major servicer and the two major investors in the country for closure prevention. So we have Bank of America, Citi, Sachs, and Fannie Mae. These are legally binding agreements: Litton, GMAC, Freddie Mac, One West, Chase, Wells. We have American Homes, HSBC. Again, every one of the major servicers in the country and every one of the major investors in the country, we have a legally binding agreement.

There are only two real solutions out there. One is to restructure the mortgage for someone with a stable income to make their mortgage affordable, not to refinance. To restructure by permanently reducing the interest rate or the outstanding principal to make it affordable, and I say permanent. That means not a reset in 5 years to make that payment affordable, and we agree with what Laura and some of the other people on the panel said: We should do more principal reductions so you can keep the re-interest rate at the market rate, and make it affordable by doing a principal reduction. That clearly hasn't happened.

The other action, which you do when someone does not have stable income, because they are unemployed, is a forbearance agreement. Lenders have been doing the forbearance agreements for many, many years, and they really continue to do that.

We have homeowners here: Dana Holmes, who is in the audience; as well as Paul Roberts. Dana went to a Save the Dream event that NACA has been doing. We have done 12 around the country. Each one has about 40,000 to 60,000 people in attendance. Paul has reduced his mortgage payment by $1,400 a month. He is at a new fixed-rate at 3 percent locked in. Dana has gone to one of the Save the Dream events, saving $833. Again, she is in the audience, with an interest rate of 3 percent fixed, as well. But I think it's really interesting to hear we have two of the major servicers here.

We have Bank of America and we have Chase. So one of the things we have heard about is what is not working. Well, let's take the two examples of who we have here. We have Bank of America. What they have done at the Save the Dream events is that they are doing on-site mortgage restructures, and that means that they get all the documents, they get the verification of income.

They get that piece done, and they actually have the homeowners signing the legal documents, signing them at the event so people in one place are walking away with a restructure, saving $500, $1,000, sometimes $2,000 a month, getting the job done. And almost 15 percent of the people who are coming through are doing that.

Then you have Chase. Chase, out of all these servicers here, is the worst. And the fact of the matter is when you look at their documentation and you look at what they're doing, they are playing you. The fact of the matter is, when they say that they are doing these trial mods, and all of that, and all of a sudden, it's the bor-

rower's fault because the homeowners can't get the documents there, it's because they're underwriting them after 3 months, so they refuse to do on-site, permanent restructures. They put people through the process.

They're impossible to work with. Talk to the homeowners about that. So I think it's a really interesting contrast that you have the one who does the best, and that's Bank of America, and the one who does the worst, and that is Chase. So when you get Jamie Dimon up here, ask him for the facts of that.

Let's talk about what the solutions are and what they really should be. Well, the Administration has to stop pleading, begging, and bribing the servicer to do the right thing, because the fact of the matter is a lot of their business models don't work. They're in the collection business. They're in the business of remitting that money to the investors. They're not in the origination business, which is what we're at now.

So the fact of the matter is, where are the OCC and the Federal Reserve? They should be requiring the servicers to do the mortgage restructures, to do what they should be doing. That's their job, and that doesn't require the TARP money. Clearly, when we had a financial crisis, we required the lender to take the TARP money, because there was a safety and soundness issue. We can have that same standard, that same standard to say, let's require the servicers, the lenders, to stop the foreclosures, to restructure the mortgages and to make them affordable without use of the taxpayer money out there.

So thank you very much. I would be glad to answer any other questions.

[The prepared statement of Mr. Marks can be found on page 115 of the appendix.]

Mr. MOORE OF KANSAS. Thank you, Mr. Marks, and I thank all of the witnesses for their testimony here today. I will start with you, Ms. Sheehan, representing Chase.

You just heard Mr. Marks's testimony. Would you have any response or any reply to some of his comments, ma'am?

Ms. SHEEHAN. We have been working with Mr. Marks's organization for quite a while. We think they do a great job in their outreach events and bringing homeowners out to talk to us. We have a process that we have established in terms of how we do our intake for our events. It is a slightly different process, perhaps, than Bank of America. And I'm sure each of us has different processes, but we have worked very, very hard to make sure that we get the documents in. We have a dedicated portal. We image documents. We put them together and then they go through our prequalification process.

I know there have been bumps along the road, absolutely, particularly in building-up capacity to manage the outreach process with Mr. Marks, but we continue to work very, very hard and we will certainly follow-up with him after this hearing and talk further about how we can do better.

Mr. MOORE OF KANSAS. Thank you. Do any other witnesses have a comment on my question? Anybody else?

When it comes to foreclosures, I continue to be troubled by stories of mortgage fraud and individuals who are trying to make a

quick buck by scamming innocent people. To any of our witnesses, what steps, Ms. Sheehan, or others, is Chase or others taking to ensure your customers are not taken advantage of? Is there enough information being provided to the general public about what a legitimate mortgage foreclosure mitigation plan is compared to a scam? Is there more education that needs to be done so innocent people are not taken advantage of? Any of the witnesses, Ms. Sheehan or others?

Ms. SHEEHAN. Certainly, there is a lot of work that needs to be done in the scam process. I think we have made a lot of progress. We have worked with the FTC making sure that we are getting information to them when we learn about scams that are going on. We have put together booklets with the FTC that we include in all of our conversations with our customers. We continually remind them that they don't need to pay for a modification.

Mr. MOORE OF KANSAS. Thank you. Do any other witnesses want to answer that question? Mr. Marks?

Mr. MARKS. Yes. The answer is, if you consider those servicers out there who are doing the fraudulent activity, you have to reconsider them as roaches out there. You can't kill off all the roaches by stomping them all out; you have to cut off their food source. And the food source is the lack of the ability where some homeowner goes to the servicer to get a real solution right then and there. So, the focus should be on really requiring the servicers to get the job done, because if you do that, then you're going to prevent all these frauds.

Clearly, it should be outlawed that no one should charge anybody to save their home because they should be working with the servicers and the nonprofits who don't charge to do that. But, we have to focus 100 percent on getting the job done. Everybody who comes to an NACA Save the Dream event has tried to work with a servicer and has failed. So, we have to really put these players out of business, and frankly, put the nonprofits, the NACA's and the like, out of business because our job should become irrelevant if the servicers are required to do these restructures and the forebearances. Thank you.

Mr. MOORE OF KANSAS. Do any other witnesses care to comment?

Mr. SANDERS. I just want to add to what he what he was saying. I disagree with, in part, what he's saying because, again, supposing a borrower doesn't like what they're hearing from the servicer. They may want to get legal representation or an organization to try to push the envelope. You have to be very careful about trying to regulate people out of these industries. It sounds good, but I think there might be people who want additional representation, although I really don't like the scammers, either.

Mr. MARKS. And we shouldn't agree with that because at these events, we also do a forensic audit of the loan, so on the pick and pay and all that, you find that 80 percent of all the pick and pays in the country that, you know, that there's something that was done illegally, so that when we do a forensic audit, we find the violations and that gives the borrower a better opportunity to get a long term solution, so absolutely.

Mr. MOORE OF KANSAS. Thank you to my witnesses. My time has just about expired. I'm going to next recognize Mrs. Capito, please.

Mrs. CAPITO. Yes, thank you. There are two things that are troubling me here. First of all is the, I guess the conflicting information, but the information that once people, well, when I learned at the last hearing that in order to go into a trial modification, you don't have to have your documentation before you. You can go ahead and go into the trial modification for 3 months without the documentation. But, according to what Ms. Sheehan is saying, and then after you're requesting these documents, that they're not forthcoming with a large percentage of the folks who are trying to modify their loans.

What is the principal reason that people aren't coming forward? Is it as the gentleman just said, they don't like what they're seeing, or they're just postponing the inevitable, or what is the reason for this?

Ms. SHEEHAN. Certainly, a lot of the situations that we see are where they have submitted some of the documents but not all of the documents. And—

Mrs. CAPITO. Exactly. They have to have income tax—

Ms. SHEEHAN. Right. So—

Mrs. CAPITO. Proof of employment.

Ms. SHEEHAN. Yes, and it could be, but frequently it may be documents that they don't have easy access to—

Mrs. CAPITO. Like?

Ms. SHEEHAN. For example, a supporting death certificate or divorce decree. Mr. Marks made the point that this is a true origination process, it's really, truly underwriting a new loan and so what we are looking at, as you said, all of the different financial aspects of their situation. And so it is a challenge for borrowers and we're trying to help them, we're trying to help them overcome that challenge.

Mrs. CAPITO. Mr. Schakett, do you have the same situation at Bank of America?

Mr. SCHAKETT. Yes. That's definitely true. I think that one thing that when they were first setting up HAMP, there was a lot of discussion around whether or not we should require full documentation, partial documentation, or no documentation to start the trial mod period. Obviously, at that time, I think there was a general consensus that we supported that we have a lot of pent-up demand right now, we need to get the customer started as soon as possible, so people erred on the easy side in the beginning of the program, they said, make it no documentation, oral commitment to what you make, start the trial period, use that trial period to gather the documentation, hopefully that you would actually then solve the documentation problem, at the same time and parallel with the 3 months' trial payments.

Clearly, what we're now looking at, we're at a pretty high fallout ratio. We think it's time probably to maybe change the process slightly. We would advocate up-front now to require some documentation, at least two documents: the hardship affidavit, which is fundamental to the program, to prove what kind of hardship, and it also has language about making sure everything you're saying is truthful; and then assign the 4506–T, which lets them know that we'll be pulling a tax return at some point in the future. So, if there are customers who potentially were trying to game the sys-

tem, that might root out those customers up-front and eliminate, maybe, some of the conversion problems we have today, so this at least is our view, it may be a good time to challenge what documentation we're requiring up-front to make it a little bit tougher to get into the program, still allowing the time to finish processing the loan, this added on to the end of the trial because that parallel processing still, I think, is a good idea, because there are a lot of documents to get and trying to get them all up-front would maybe unnecessarily delay the start of the process.

Mr. MARKS. And if I can add just one thing to what they're saying is that, it's not a difficult process. It's really a simple process. If we can do it in the same day, get same-day solutions, all you need is three documents: the hardship affidavit; the 4506–T authorization; and verification of income. So, we don't believe that you should do the no-docs. We believe in the trial mods, but you should underwrite it on day one, end it, get it done, after 3 months of making on-time payments, it gets done.

The other problem is that homeowners have lost confidence in the servicers. And so, if the process doesn't work, people don't trust the servicers out there, and somehow, we have to re-establish the trust between the homeowners and the servicers. But, just get it done at the beginning, get the verification. I think that the fact of the matter is, they required more documentation at the beginning of the process. The Administration has made it a simpler process so—

Mrs. CAPITO. Well, I would certainly say that, to have some up-front documentation, like I said, I was astounded to hear there was no documentation in the beginning. This is the problem that we had when we started. And I am talking way back here.

The other thing, I think that Ms. Goodman brought up, was that the negative equity situation when challenged whether it was unemployment driving a lot of this now. Well no, not really, it's more negative equity or people are underwater. I don't see how you solve that problem. Luckily, I am from a State, West Virginia, where we don't really have that problem, but these States like California, Florida, and Nevada, they are so far underwater. They are underwater by amounts that are more than the median home price where I live. And, people have to feel just desperate, that there's no way that they can get out from under. So, I think that is a huge hurdle to overcome here and it's one that you can't do overnight. It's not like, you have lost your job, you have a new job. It's like, you have time here, and I think my time's up, but anyway, that's just a comment I wanted to make. Thanks.

Mr. MARKS. Is it possible to respond to that? Do you mind? If I can do that quickly?

Mr. MOORE OF KANSAS. We do have other people who want to ask questions. You can respond in writing. In fact, the Chair encourages anybody who would like to provide additional testimony, to give us written testimony that will be provided to the members up here. Thank you, sir. The Chair next recognizes Ms. Waters of California for 5 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman. And I apologize for not being able to get here earlier today. Let me just say that I have spent a lot of time trying to understand why we can't

get loans modified quicker. I don't buy the White House's latest attempt to prod servicers into doing loan modifications. I don't think the jawboning and trying to embarrass these servicers into doing the right thing works.

I think that we have to have stronger legislation. I think I understand a lot about loan servicing, and Mr. Marks, you're absolutely correct. I see no reason why you cannot do a loan modification in the same day that you're contacted, with limited documentation. I'm not saying no documentation. But you know, this business of the trial for 3 months and then the request for 6 months' worth of bank statements and on and on and on.

In my office, we're helping people 75- and 80-years-old try to put together requests from servicers that professionals working every day can't put together very easily.

And the other thing is, these many servicers, why do you lose so much? Most of the time, I'm getting calls about people having to submit papers a second and a third time. Also, I get the feeling that some of our companies have just brought in servicers and they gave them a 2½ hour training session and put them out there to try to do loan servicing, and then they tell my constituents they can't take into account certain kinds of income that are not valid.

I don't care where the money comes from. Child support, unemployment, Social Security, all of that should be taken into consideration. But, I'm talking to servicers, because I get on the phone with them, and I get on the phone with my constituent, I get a waiver for my constituents to talk directly to the servicers, to assist them.

I'm just amazed at what appears to be incompetence. I'm amazed at the requests for all of this documentation: the bank statements; the tax filings; and on and on and on. It is not necessary and they're not getting it done. We know that they are not getting it done. The White House is embarrassed about this and people are losing their homes who could remain in their homes.

In the Recovery Bill that is going to be on the Floor tomorrow, we're going to try and do something for the unemployed because we have reverse mortgages where people get reverse mortgages, get money up-front, and then when the house is sold, or what have you, the money is paid back. We could do that with the unemployed, you know, when the house is sold, we could lend money up-front and they could pay it back when the house is sold.

But, I tell you, there is not a real effort by the mortgage companies or the banks or the servicers, or whomever, the banks own most of these servicers and operations, to really do loan modifications. That's the bottom line. You don't want to do them. And so, not wanting to do them, you don't care about HAMP or anything else, you just don't want to do them, so I am looking for stronger legislation to force these modifications. I'm looking for ways to expedite, as Mr. Marks explained, and I didn't hear some of the other testimony.

But, it's not a lot that can be told to me about the "can't be done," that people are not getting their paperwork in, that somehow people signed on the dotted line and now they don't want to take responsibility.

I have been looking at, if I may, I have been looking at some of these mortgages where they readjust in perpetuity. They readjust

every year for the rest of the loan up through 2034, 2035, and on and on and on. Those should be modified on the spot. It has nothing to do with anything except that's a predatory loan.

And for those servicers and those companies who have those bad products that are out on the market and they have people who are in trouble and they're saying they can't modify those loans, I'm coming after them with some real legislation to do so. Some of the loans are predatory. Some of them are, people have been defrauded and I want those loans modified even if they work every day and they can afford to pay the loan, those loans have to be modified along with people who don't have the money because they have lost their jobs, etc. I yield back the balance of my time. There is not a lot else to be said about this mess, Mr. Chairman.

Mr. MOORE OF KANSAS. I thank the gentlelady for her questions and her comments. Next the Chair recognizes—

Mr. MARKS. If I can just comment—

Mr. ROYCE. I think we're into my time now.

Mr. MOORE OF KANSAS. It's Mr. Royce's time. The Chair will recognize Mr. Royce for 5 minutes.

Mr. ROYCE. Thank you, Mr. Chairman.

Mr. MOORE OF KANSAS. And I want to say—excuse me—to the witnesses, that they have an opportunity to submit written statements, as well. Mr. Royce?

Mr. ROYCE. I appreciate that, Mr. Chairman. I just make mention here, Ms. Sheehan in her testimony said that JPMorgan Chase had successfully prevented 730,000 foreclosures and Mr. Schakett mentioned that the Bank of America assisted 615,000 customers in the first 6 months of 2009 to refinance into more affordable mortgages at a lower interest rate. Now, the Administration and some of the Members of Congress here would like to change the Bankruptcy Code so that bankruptcy judges could write down principal. This doesn't just have to do with writing down an interest rate; it has to do with reducing principal on a loan. And if the borrower understands that if they wait and don't renegotiate because we might do these huge write-downs of principal, why would the borrower continue to work at the table to try to stay, try to work out an arrangement for a lower interest rate? That would be one of the questions that I would ask.

Mr. Schakett, do you have any thoughts on that? What would happen, in other words, to your efforts to restructure, to continue to restructure these loans, should that kind of legislation pass?

Mr. SCHAKETT. Well, certainly there is risk if the customer believes he has two outlets to restructure his loan. One, to work with the mortgage company in existing programs like HAMP to modify or seek judicial process to modify, and if he believes he could get a better deal judicially, you're right, there is some risk it actually would undermine the HAMP program.

You know, our view is if the Congress and the Administration determines we should do more in principal reductions for certain borrower segments, we have to work that into some leg of HAMP, okay? And I think there could be some borrower segments, very high LTV's, the late stage delinquencies, that because there's a large unwillingness problem, maybe there should be some sort of a principal forgiveness program that the government participates

in. But, it would be best served, I believe, by putting that through a process that works for everybody and is actually sponsored by the Administration itself versus through a judicial process.

Mr. ROYCE. You see, one of the concerns I have here is having fought in the past against some of the policies that encourage Fannie Mae and Freddie Mac to do some of the types of lending they did with zero downpayment loans, subprime loans, half of their portfolio being subprime, my concern is that we now go to a situation where if this cram-down concept goes through, it's going to have an effect in the future on mortgage rates. And I want to ask Professor Sanders about this.

What's going to be the effect going forward on the secondary market? Are lenders going to have to reprice their consumer mortgage products in order to adjust for the risk to investors presented by something like bankruptcy cram down? Is that the likely consequence of legislation like this?

I remember a Justice, Supreme Court Justice John Paul Stevens' comment that there's a reason the Bankruptcy Code does not treat residential mortgages like it treats credit cards or auto loans. And basically, what he said was, we want to ensure investment certainty and encourage the flow of capital into this market. If Congress keeps making mistakes, errors in judgment, that balloons the market, like what was done with Fannie Mae and Freddie Mac, and then comes back with cram-down, or legislation like that, do we drive the private capital out of the market?

At the end of the day, I don't think Congress did any favors for disadvantaged people by pushing Fannie Mae and Freddie Mac and mandating that half of their goals, mandated that half of that be subprime and Alt-A loans. That was a huge mistake for Congress to make. Zero downpayment loans, frankly, by Fannie and Freddie, that was a huge mistake. We're now living with the fact that people took advantage of that, obviously, as everybody would. If you could capital at those rates and with no money down, if you could flip homes, 30 percent of the homes in 2005 were flipped in this country.

So, we knew what was going on. Let me ask you, Professor, your observation on that.

Mr. SANDERS. Well, first of all, I think you were spot-on at the beginning that the write-down of principal, while it is desired by anyone who is in that position, has serious moral hazard implications about waiting and actually going to the default if you know you're going to get a principal write-down. But secondly, on the secondary markets, Andy Davidson and I wrote a paper for the MacArthur Foundation called, "Securitization After the Fall." And what we said was, if we want to get the whole securitization market, which is really, really important for the mortgage market and the housing market to recover, we have to establish trust so investors around the world, the United States pension funds, have to trust that the securities market is going to work, etc.

And the problem is, if we go to cram-downs, cram-downs, I think, will send a shock wave through the international markets that, oh, my gosh, we're going to allow judicial intervention, and they're probably not going to be consistent, they're going to vary by juris-

diction, it's just a terrible signal we're sending to the capital markets around the world, if we pursue that.

Mr. ROYCE. As nobly intended as it is. Thank you, Professor. Thank you, Mr. Chairman.

Mr. MOORE OF KANSAS. Thank you. The Chair will next recognize Mr. Clay of Missouri for 5 minutes.

Mr. CLAY. Thank you so much, Mr. Chairman. Along the same lines as Ms. Waters, some of the strategy that we see now deployed by mortgage holders and banks does not make good economic sense. Why haven't we seen an effort to keep people in their homes instead of removing them? And then leaving the home vacant and reducing the value of the surrounding property in the neighborhood. If it is about the bottom line and profit motive, would it not be a better business strategy to keep people in homes? Doesn't the mortgage holder or the bank have to maintain utilities and to keep the water on in those facilities?

Let me ask someone on the panel, and maybe Ms. Sheehan or Mr. Schakett could take a stab at this. What is more cost-effective for banks and mortgage holders, to evict and/or foreclose on a home, is that more cost-effective, or would it be better to work out some arrangement, even if the homeowner is reduced to paying rent in order to keep them in that house? What would be more cost-effective to the banks or the mortgage holders?

Ms. SHEEHAN. I would say that, obviously, when we look at our distressed borrowers, the first thing we do is make a consideration about whether or not we can achieve an affordable and sustainable monthly payment for their housing under a modification program. That's what we're trying to do because generally speaking, that is going to be more cost-effective from an investor or lender perspective than a foreclosure. So, absolutely, that is part of the process that we follow.

Mr. CLAY. Well, but think about the difficulty when you remove a family from a home, then it's vacant, then you drop the overall value of the homes in that neighborhood. Then, your profit is reduced when, even if you're able to sell that home. It is just a strategy. Mr. Schakett, you may—

Mr. SCHAKETT. Well, you're right. There's no question. When we make the calculation, is it better to try to make an affordable payment for the customer versus take the home away from the customer, part of the calculation of taking the home away recognizes that if we take it away, we do have to pay the bills while he's not there, there are eviction costs, it does take a while to market the property, the property could decline in value further which makes it even worse for us. So, all of those calculations are part of the math which weighs heavily in the favor of the consumer that says as long as he can make some kind of reasonable payment, it is almost always better to keep the customer in the home. That's exactly right.

Mr. CLAY. But we are not seeing that trend now among mortgage holders who are saying, let's make every effort to keep people in their homes. We're not seeing that.

Mr. MARKS. Sir, if I can respond?

Mr. CLAY. Yes.

Mr. MARKS. Because there are two separate pieces. One is the servicer. If the servicer does nothing, and it goes to foreclosure, they lose nothing. The other is the investor. And then we always hear from the servicer that says, you know, we would love to do it, but the investor says, no. The fact of the matter is, they virtually never, ever contact the investor. What they do is they go to the trustee who tends to be the same entity the servicer is and says, what does the pooling and servicing agreement say? That's the contract between the servicer and the investor. So, while they say it's the investor's problem, it's not. When you talk to PEMCO and the biggest investors out there, they say, we want to do these modifications, we actually want to do the principal reductions. But we're not seeing that. So, the fact of the matter is, the servicers lose very little if it goes to foreclosure. It's the investor who loses. And they very seldom ever talk to the investor and then the lawyers for the servicers says, well, they take the conservative approach. So, they find a reason to say no, as a reason to say yes, but reading the pooling and servicing agreement, the PSA, in a very conservative manner, which hurts everybody, as you say, sir.

Mr. CLAY. Well, don't the servicers have a fiduciary responsibility to the investor?

Mr. MARKS. That's right, and you know, from our opinion, we think that they're in violation of their fiduciary responsibility because they find a reason to say no when their approach has been the opposite, where they should be saying yes in a lot of cases.

Mr. CLAY. Thank you.

Ms. GOODMAN. Let me just make one more point and that is that many borrowers are so far underwater that they don't want the modification; the current modification program doesn't work for them. You need to go to some sort of a principal reduction program. They still legally owe the money even if they're making a lower payment.

Mr. MOORE OF KANSAS. The gentleman's time has expired. Any other witnesses who with to make a comment are certainly invited to do so in writing, please, for the record, because that is helpful. The Chair next recognizes the gentleman from California, Mr. Baca, for 5 minutes, sir.

Mr. BACA. Thank you, Mr. Chairman, and thank you for holding this hearing. In my area, we probably have the third or the fourth highest foreclosure rate in the Nation, so it has really impacted the Inland Empire, and in my neighborhood, I have homes that are basically vacant or have just been rented. And it seems like many individuals who have lost their homes or are in the process of losing their homes are stating, why should I continue to pay the high rates that are currently there right now when the property value has even gone down so much, so they end up vacating their home and then renting, which is a problem that we have.

But my question pertains to the HAMP program. A lot has been made about the HAMP program and its inability to help families whose breadwinners have become recently unemployed because of the current economy. In many of these situations, it is actually better for the lender to foreclose on the property and I state, it is better for the lender to foreclose on the property.

Moreover, there is evidence showing that permanent modifications for unemployed individuals actually end up hurting the taxpayers because of the government ownership of Fannie and Freddie. Because of this, there have been plans that actually called for limited modification for unemployment and actually called for use of housing vouchers or grants to be used. Could you comment on the feasibility of such an approach, addressing what's possible, pros and cons that may be, and I address this question to Mr. Marks.

Mr. MARKS. Sure. Thank you. One is that, with someone who is really unemployed, servicers have done this for many years, there's a standard practice where they do a forebearance for 3 to 6 months. And, you know, they should be doing that. So, you don't need MHA, frankly, you don't need the government subsidies to help the servicers to do that. So, it's really an enforcement part.

The other problem, and I think it's a very good point, is that we are getting people locked in at a 2 percent interest rate for life. Well, that's a nice piece, but that shouldn't be the answer across-the-board. What should be the answer is, let's put someone on affordable payment at a market rate and reduce the outstanding principal because that's better for the economy, it's better for the homeowner, it's better for the community.

And under MHA and under HAMP, you see virtually no solutions when there's a principal reduction or forebearance. Everything is interest rate reduction. We don't think that's the right answer across-the-board. We agree with the investors out there who say that is not the right answer across the board. They would rather have a significant principal reduction closer to the current value of the property and keep the interest rate at the market rate and we think that, you know, MHA and HAMP, should be reconfigured to re-encourage that, please.

Mr. BACA. Thank you. And you're saying that the current rate of the market today, not what it was before they foreclose, is that correct?

Mr. MARKS. Absolutely. It's all about the affordable payments, how you get to the affordable payment, so once you look at 31 percent of the gross income or you take the net cash flow to determine an affordable payment, which is less, then how you get there is up to the servicers and the investors. And while you can reduce the interest rate to 2 percent or 3 percent, like you have heard here, to get to that, maybe you could keep it at a 5 percent interest rate and reduce the outstanding principal by $50,000 or $100,000 to get closer to the current value of the property.

Mr. BACA. Mr. Sanders, would you like to tackle this?

Mr. SANDERS. The whole issue of the interest rates is a fascinating one. I think we are price stressing it too much and the one thing I want to add to that, though, is that I'm hoping everyone considers the fact that if we do, in fact, move to 2 percent loans for a large segment of the population who are in financial difficulty, etc., which again, is very noble sounding. So, I want to point out that somebody's going to be holding those notes, and when high inflation and high interest rates suddenly go ka-boom in a few years, which they will, whoever's sitting on that paper is going to have catastrophic losses. Right now, the Fed is sitting on that, but

Freddie is insuring this and we have to again, be, I think, very careful of the long-run implications of what we're doing here.

Mr. BACA. Yes, but the people who are holding those notes really have been the greedy ones who took advantage of those individuals, right? So why not make them lose? If those are the ones holding the notes, hey, I don't mind them losing because they got greedy in the first place.

Mr. SANDERS. Well, if pension funds and the Federal Reserve are the greedy ones, then I don't think so. This is going to hurt a lot of people and it's just not what you call the greedy folk, it's going to be folks around the world who are going to suffer when we get inflation and interest rates going up.

Mr. BACA. Okay, thank you. Thank you, Mr. Chairman.

Mr. MOORE OF KANSAS. Next, the Chair recognizes the gentleman from North Carolina, Mr. Miller, for 5 minutes.

Mr. MILLER OF NORTH CAROLINA. My impression from that period is that the voluntary modifications took a huge spike, and that the total number of modifications by courts was a relatively small percentage. But it provided a template for other modifications.

Ms. Gordon, are you aware of what went on during that period? Was there a dip in voluntary modifications?

Ms. GORDON. No. There was not a dip in voluntary modifications. And to add to what you just said, in a number of States around the country—until the Supreme Court decision on this topic, many States permitted bankruptcy judges to "cram-down" principal residence mortgage debt in bankruptcy court, and those States didn't have any different situation with respect to the cost or availability of credit than the States that didn't have it.

Bankruptcy is a very difficult process for an individual or a family. Chapter 13 bankruptcy is onerous. You have to live under a very strict plan. You're monitored by the court for 5 years. This is not a choice that anybody chooses lightly.

We have two situations now. We have the situation in that the voluntary modifications are not happening, and it is all utterly out of control of the homeowner. They have no last resort that they can initiate themselves which would serve as a backstop to the servicer's responsibility to help them try to address whatever problems they're facing with the mortgage. So, on the one hand, the ability of the bankruptcy judge to help a homeowner out gives a homeowner a last resort.

We have another situation in that many of these distressed homeowners are financially distressed generally, and already are filing for bankruptcy. They're already in bankruptcy court. It's just that the judge doesn't have the power to do the main thing that will actually ultimately make them successful in Chapter 13, and able to continue to pay back all of their other consumer debt that they owe, which is that the judge doesn't have control over their principal residence mortgages.

For those homeowners, one thing that is especially important is right now most participating servicers aren't permitting folks who are already in bankruptcy to do a HAMP modification. So they're really stuck. They can't get the voluntary modification because the servicers don't want to do it for people in bankruptcy. But the

bankruptcy judge can't help them out, either. So those people are really locked out of the process.

Mr. MILLER OF NORTH CAROLINA. Ms. Gordon, you mentioned studies based upon the differences from jurisdiction to jurisdiction between, I guess, 1978 and 1994. There was a study I know by a fellow named Leviton at Georgetown, and I think he had a co-author who was, I think, at Columbia. I think they were both economists and lawyers, bankruptcy lawyers, who looked at the differences and found no difference in the availability or terms of credit. Is that what you're—are there other studies, or—

Ms. GORDON. There are not that many studies on this particular issue. But there are a number of studies, some of which we have done at the Center for Responsible Lending, some of which have been done at UNC and other research institutions on related issues.

You know, the fact is, every time there is a program—there is an idea to help homeowners—

Mr. MILLER OF NORTH CAROLINA. Okay.

Ms. GORDON. —the mortgage industry will come back and say, "Well, this program is going to impact the cost and availability of credit."

Mr. MILLER OF NORTH CAROLINA. Right.

Ms. GORDON. And for every one of those—every time that has been asserted, studies have demonstrated that it's not the case.

Mr. MILLER OF NORTH CAROLINA. In an 8th grade math class, we had to show our work. We just couldn't give an answer, we had to show how we got there. And I understand at the graduate level that's referred to as peer review. You have to set forth what your assumptions are, what your methodology was, what facts you relied upon, and then your analysis, and walk through the analysis. And then other scholars in the same field can look at it and test those assumptions.

Mr. Sanders, are you—can you give me a citation to a published, peer-reviewed study that shows that judicial modification makes voluntary modifications more difficult?

Mr. SANDERS. That's a very good question. And I will send it back to you, saying that we are—as Laurie has testified to—we are in such unchartered waters that all that matters is, with a 50 percent decline in house prices, we will see how this works.

No, I have no evidence that—Ms. Gordon was referring to—that this was going to be terrible. However, when we're this—with high unemployment and this far upside down in many—or 10 States, at least, in the United States—I will believe that when I see it.

Mr. MILLER OF NORTH CAROLINA. Professor Sanders, isn't it true that under the bankruptcy laws, every other kind of secure debt can be modified in exactly the same way that the legislation we talked about last year would modify home mortgages? Every other kind of secure debt?

Mr. SANDERS. That is true.

Mr. MILLER OF NORTH CAROLINA. Okay. Thank you.

Mr. SANDERS. But there is a reason why they're not.

Mr. MILLER OF NORTH CAROLINA. I'm sorry. What?

Mr. SANDERS. There is a reason why mortgages were not included in that—

Mr. MILLER OF NORTH CAROLINA. That's the only reason?

Mr. SANDERS. No, I didn't say that is the reason. I am saying mortgages are not included. And that was a statement.

Mr. MILLER OF NORTH CAROLINA. Okay.

Mr. SANDERS. Not a reason.

The CHAIRMAN. The gentleman from Georgia.

Mr. SCOTT. Thank you, Mr. Chairman. Let me start with this, because we're in a terrible situation here and I have had difficulty since we have been in this crisis of understanding why there has not been a sense of urgency.

Now, we have moved in good measure to save Wall Street. I had no argument with that. The credits were frozen up; we had to do that. But we did it with urgency. We did it with abundance. We did it $700 billion first. The Fed came in with another $1.2 trillion. But when we get down to the homeowner, we crunch and we worry about these things.

We went outside the box to save the American economy focusing on Wall Street, and did a good job with that. No question. But when it comes down to rescuing the homeowner, which, in large measure, was the core cause of the problem, we stay in this box. Why is it that we can't intelligently look at what I think is the foremost issue here? And that is reducing the principal. Why is it—what is it about this?

Here we are, at the end of this year, we will lose 2.5 million homes to foreclosure. Right now, two out of every nine homes are in foreclosure or default. This is a problem of catastrophic means. Why can't we do that? Why can't we stop the foreclosure procedures while the modification process is going on?

These are simple things. I just have a problem understanding why we can't do this. Why can't we look at this home modification program, affordability program, and understand that maybe that 31 percent is too high, especially when people are losing levels of income?

Can somebody help me with this? Let us start with the reduction of the principal. I would like to know, from each of you, why we can't do that. What is the problem here?

Mr. MARKS. Can I just ask one thing? I think one question to the servicers is, in their model, when they look at the affordable payment, do they have the process in place to do the principal reduction, as well as the interest rate reduction?

And then, when it comes to the MHA program, or HAMP, why don't they encourage the principal reduction versus just the interest rate reduction? Because we agree—and we see very few of those out there.

Ms. GORDON. Well, there are a few structural reasons of conflict of interest why servicers may not do this. One is that the biggest servicers, and the ones that service the vast majority of the loans out there right now are owned by the same banks that hold many of the second liens on these loans, so they have a conflict of interest, in terms of writing down the principal.

Servicers generally make most of their money from their monthly servicing fee, which is a percentage of the outstanding loan principal balance, so they don't want to write down the principal balance. There are a number of other financial conflicts, too, that have

to do with right to residuals or buy-backs or any number of structural things in the servicing industry that push against this.

And so, the real question is, why have we not been willing to require that this happens? If we just leave it up to the banks' interests, the banks have different interests. Congress is going to need to require that this happens, and you are completely right, that we have not put the energy into this issue. You know, the foreclosure crisis has basically been something of a—

Mr. SCOTT. Right.

Ms. GORDON. —50-State Katrina, sucking money out of communities, particularly minority communities, and just leaving husks of neighborhoods in its wake.

Mr. SCOTT. Ms. Goodman?

Ms. GOODMAN. I will actually second what Julia Gordon said. The conflict of interest between the borrower and the second lienholder is huge, in terms of writing down principal.

And before you can have a successful principal reduction program, you have to explicitly address the second lien. There seems to be no other option, other than extinguishment. You may want to pay the bank to extinguish the second lien, you may want to let them take the loss over a period of time, but that simply has to be done.

Another problem that has often come up in terms of principal reduction is the moral hazard, or strategic default problem. How do you keep borrowers who otherwise could afford to pay their mortgage from strategically defaulting, or trying to take advantage of a principal reduction plan? There is no single option here. But, as you mentioned, we have to think outside the box. We have to think in terms of shared appreciation features, requiring all reduced principal mortgages to be made with recourse, introducing an impact on credit scores, limiting future access to credit or limiting the ability to borrow against the property. We have to consider a wide range of ideas, but certainly the strategic default issue plays a very prominent role in people's minds.

Mr. SCOTT. Thank you. My time has expired. Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from Texas.

Mr. GREEN. Thank you, Mr. Chairman. I thank the witnesses for appearing.

The 3/27s and 2/28s, are we still having a significant number of them come through the process?

Ms. GOODMAN. The bulk of those payment shocks are behind us. It's the pay option ARM payment shocks that are left to come.

Mr. GREEN. And are we now finding that persons who had conventional loans, reasonable rates, are also starting to default?

Ms. GOODMAN. Absolutely. Negative equity is just a huge problem at this point.

Mr. GREEN. And is the problem one that you can, with some degree of anecdotal evidence, indicate that certain communities have experienced to a greater extent than others?

Mr. MARKS. Absolutely. When you go to the—

Mr. GREEN. Let me just take your "absolutely" as the answer—

Mr. MARKS. Yes.

Mr. GREEN. —and ask another question if I may, please?

Mr. MARKS. Yes.

Mr. GREEN. Can you identify communities by way of empirical and anecdotal evidence that have had a greater shock than some others?

Mr. MARKS. Yes. But I would also add that this has become more across-the-board in virtually every community and in every State.

Mr. GREEN. Given that it has embraced every community and every State, but some more so than others—

Mr. MARKS. Yes.

Mr. GREEN. —kindly identify communities that have ostensibly been hit harder than others?

Mr. MARKS. You certainly see the minority communities, and you see—

Mr. GREEN. Define "minority communities."

Mr. MARKS. The communities where the majority of the population are African American, Hispanic, and other ethnic minorities, and low- and moderate-income communities, communities where the median income is less than 80 percent of the median.

Mr. GREEN. Whether by accident or design, this impact on these communities that seem to have been hit harder than others, what will happen, in terms of recovery, for these communities without some intervention?

Mr. MARKS. Absolutely devastating. You see the foreclosures, you see—

Mr. GREEN. Tell me about the loss of wealth for these communities.

Mr. MARKS. It is massive. I think there are other people on the panel who can actually empirically identify that, and they should—

Mr. GREEN. Is there anyone who can give some empirical evidence?

Ms. GORDON. Yes. Our research reports show what we call spillover effects of the foreclosures, really, in the hundreds of billions of dollars. And, there are two types of spillover effects. There is the general reduction in everybody's property value, and—

Mr. GREEN. Are you talking now specifically about the communities that were referenced by Mr. Marks?

Ms. GORDON. Yes.

Mr. GREEN. Identify—

Ms. GORDON. The more foreclosures there are, the worse the—

Mr. GREEN. For the record, I need—

Ms. GORDON. —spillover effects.

Mr. GREEN. —for you to identify the communities that you are talking about.

Ms. GORDON. Largely communities that are African-American or Latino communities, or lower income—you know, the more lower, middle-income—

Mr. GREEN. Will these communities—

Ms. GORDON. —homeowner communities—

Mr. GREEN. Will these communities recover without some specific intervention?

Ms. GORDON. Absolutely not.

Mr. GREEN. Does someone else have an opinion that you would like to give, with reference to this?

[No response.]

Mr. GREEN. Anyone else?

[No response.]

Mr. GREEN. This is the moment. This is the moment to speak truth to power. You hear that phrase used quite a bit. People fear speaking truth to power. Somebody has to tell the truth about what's happening to certain communities in this country. This is your moment.

Ms. Sheehan? Speak truth to power.

Ms. SHEEHAN. We have established our Chase homeownership centers in the most hard-hit communities. We are there to help people through those centers in person, and address their needs. And that is the process we have used to think about how we can best be useful.

Mr. GREEN. Do you agree that certain communities are being devastated, if not obliterated, by virtue of what happened, whether it was by accident or design that this is happening?

Ms. SHEEHAN. I don't have that kind of data here.

Mr. GREEN. Without data, you do have anecdotal evidence. You are involved in this process, true?

Ms. SHEEHAN. We are involved in the process. And as I said—

Mr. GREEN. What does your anecdotal evidence connote?

Ms. SHEEHAN. What our evidence, what our experience has told us, is that there are communities where we have—

Mr. GREEN. Are you afraid to say it, Ms. Sheehan? Are minority communities being devastated more?

Ms. SHEEHAN. Minority communities are definitely having problems, we know that, as well as—

Mr. GREEN. Are they having more problems, Ms. Sheehan?

The CHAIRMAN. Let me just say—I haven't used my 5 minutes. I'm not going to take the whole 5 minutes, so I'm going to yield 3 minutes of my time to the gentleman from Texas, so he can continue.

Mr. GREEN. Thank you, Mr. Chairman. Ms. Sheehan, let us not be euphemistic about this. Let us not let our inhibitions prevent us from telling the truth. This is a moment in time when people need to hear the truth, because we have people who are suffering. Some are suffering more than others.

Is the minority community suffering more than some other communities?

Ms. SHEEHAN. We know that we have an obligation to all of our communities, including our minority communities, and we are working—

Mr. GREEN. So you subscribe to the notion that a rising tide raises all boats?

Ms. SHEEHAN. We have an accountability to help our customers, and—

Mr. GREEN. I assume that is true. Let me ask you this: If a rising tide raises all boats—and I am putting these words in your mouth; you can extract them if you so choose—why is the Titanic still on the floor of the ocean?

A rising tide—see, I'm bringing this up because this seems to be a prevailing theory, that if we do, across-the-board, the right thing, we will help everybody. And we don't seem to understand that

some are being left behind, even with the best of intentions. We are leaving people behind.

And this is something for which I thank God that CNN has decided that they are going to monitor and report on. Because if we wait on persons to come before us with these panels and tell the truth, we may not get the entirety of the truth. For whatever reasons, we don't want to face a fact. Whether by accident or design, some communities are suffering more. And they are not going to recover without some sort of specific intervention. That's the truth. Anybody differing with that truth, raise your hand. Let the record reflect that no one has raised a hand.

My final comment, Mr. Chairman, if I may, is this. I beg you, friends. Let's get beyond splitting hairs, and let's talk about how we are going to save this country. It's really bigger than any one group of people. It's about this country. And we have to do better. We have to do better.

All of these banks have to do better. If you don't do better at some point, you're going to force Congress to take drastic action that some would call a moral hazard, because we have to have some means of having these servicers take the responsibility and do something to help people who deserve and merit help.

Thank you, Mr. Chairman, I yield—

The CHAIRMAN. I will just take my last 10 seconds here on this to give a different variant to the gentleman's metaphor. It has always been my view that while the rising tide may lift all boats, for those people who can't afford a boat and are standing on tiptoe in the water, the rising tide is very bad news, in fact.

The gentleman from Missouri?

Mr. CLEAVER. Thank you, Mr. Chairman. Thank you, Mr. Green.

I am interested in—in order that I can read it and become more familiar with it, Professor Sanders, was there an administrative order or some kind of congressional vote that directed Fannie and Freddie to make bad loans?

Mr. SANDERS. No, I don't believe there was any administrative order asking them or requiring them to make bad loans.

Mr. CLEAVER. The only reason I ask that is because earlier you, in responding to one of my colleagues, accepted in your comments that it had happened, and went on to describe how troublesome it was.

We can try to get it read back. It was a question from, I think, Mr. Royce. You don't remember?

Mr. SANDERS. I don't believe I would say that, because I don't think Fannie and Freddie purposely went out and made bad loans, or were ordered to do so. Is that what your question is?

Mr. CLEAVER. Yes.

Mr. SANDERS. No, I didn't—wouldn't have—said that.

Mr. CLEAVER. So that hasn't come up today since you've been here?

Mr. SANDERS. No. In fact, Fannie and Freddie were only mentioned, I think, by me. And that's not what I said.

Mr. SCHAKETT. Well, I think the comment was that Mr. Royce said something like, "Fannie and Freddie had an obligation to do 50 percent of their product in subprime or alt-A," and he viewed

that as a problem, okay, a mandate to do that. So that's the comment, I believe, that was said.

So you can imply that was to make bad loans, but I think it was to use 50 percent of their volume for subprime and alt-A is what Mr. Royce said, if I remember right.

Ms. GORDON. And we did not have a chance to rebut the ongoing incorrect assertion that has been rebutted by everyone from the Board of Governors of the Federal Reserve on down. The toxic loans that caused this housing crisis were primarily private loans that were securitized into the private securities market.

Mr. CLEAVER. Yes, I understand that. You know, I just hear over and over and over again that, somehow, either Congress or President Bush or somebody forced Fannie and Freddie to, you know, to bundle and securitize some bad mortgages. And I—

Mr. MARKS. Actually, sir, we had testified on September 12, 2000, in front of Congress right here, saying that Fannie and Freddie should not be allowed to get into those types of products out there.

But no one forced them to do it. You're exactly correct. No one forced them to do it. And certainly, the entities we don't see up here are the New Centuries, the Fremonts, the First Franklins, and all those who have been in the forefront of predatory lending, because, clearly, they're out of business now.

Mr. CLEAVER. So I guess it doesn't matter how many times or how many people dethrone that notion, people are going to continue to say it. Is that what you hear, Ms. Gordon, is it what you believe?

Ms. GORDON. Yes, it's hard to know how to stop that from coming up over and over, when it has just been clearly debunked as a reason.

Mr. CLEAVER. Okay. Mr. Schakett, you know, this whole term "hell," you know, the word "hell," it actually originated because on the west side of Jerusalem, where they—the land field where they burned the trash was called "sheol," and the interpretation comes down as "hell." That was the first view of what humans thought hell would be, you know, burning, constant burning of the trash.

And there are people who tell me they go to phone tree hell when they are trying to talk with someone about their mortgage, and trying to get some kind of modification, that they actually go to phone tree hell, and that they are being—their concerns, their interests, their desires, their frustration of being burned, sitting on the phone.

Do you believe that we have been able to put out the fire in hell?

Mr. SCHAKETT. No, I don't think we put out the fire yet.

I agree that certainly we have frustrated our customers. But volume is sometimes—we haven't had the ability to handle the volume necessary, and not always provided the right answers to the customers, or moved them around from one person to another, and not given them the right answers as we try to staff-up and train people.

So, I could appreciate, you know, your constituents, okay, being frustrated with that process. We obviously continue to add resources and training and try to improve. We are not—

Mr. CLEAVER. But do you think that—

The CHAIRMAN. I am going to give the gentleman an additional minute-and-a-half for biblical exegesis.

[laughter]

Mr. CLEAVER. Thank you, Rabbi.

[laughter]

Mr. CLEAVER. I am just concerned—

The CHAIRMAN. If you stuck with the right Testament for me—

[laughter]

Mr. CLEAVER. You know, I am wondering if the phone tree from hell is one of the reasons for the fact that 25 percent of the borrowers who come in for modification end up losing their homes. They can't even go through the three-payment trial period. They lose their home right off.

And is there a reason for that, or can the phone tree hell be part of the reason? Either you or Ms. Sheehan?

Mr. SCHAKETT. Okay, and I certainly believe that the phone tree problems clearly frustrate our customers. The only good news about that is that we clearly have not taken customers through foreclosure while we worked within the trial period.

So, although we may not answer the phone in a timely manner, although we may have frustrated them, all those people are in foreclosure hold. So I assure you that nobody is getting foreclosed on because of it. That doesn't undermine that, you know, there is not huge frustration, and that we need to improve that.

Our more recent mailing, we mentioned earlier, we actually sent out 50,000 letters to try to say exactly what we were still missing from these customers, and what it took to comply. It was our attempt, somewhat of our attempt, to make sure the customers that we didn't handle right in the past now knew exactly what we needed from them, and give them an easy way to respond back to us to try to get these modifications complete.

So, again, I appreciate that we have frustrated our customers. But we haven't foreclosed on them in the meantime.

The CHAIRMAN. The gentleman from Florida.

[No response.]

The CHAIRMAN. Then I will just take my last minute-and-a-half to say this: We are terribly frustrated by what's happening.

We are going to move forward on the unemployed. I understand that doesn't solve all of the problems, but I do think this is helpful. And the bill that has come to the Floor will have $3 billion to be advanced to people who are unemployed, to help them avoid it. It's a program that has worked well in Philadelphia. We will continue to push for other things.

But the most important thing, I think, is a point that the gentleman from California has consistently made. Going forward, this committee will make a very high priority passing legislation early next year that will prevent us from being entrapped in this again. There will have to be, for any residential mortgage, one party that is solely, fully, legally responsible for these decisions.

And people who want to invest in mortgages, people who want to make second lien loans, people who want to invest in the securitization will do so, going forward, knowing that those rights are subject, whatever they have, to the responsibility of one individual to make those decisions, because it is a terrible example of

our violating an important principle that ought to exist in the law: You should not have important decisions be made in this society that cannot be easily made by somebody.

And so, that is something the gentleman from California identified early. And that doesn't get us out of this current thing, but we do—and we will work with many of you, going forward, to make sure that we have that, so that we will not have this shifting of the blame back and forth.

Beyond that, we appreciate this hearing, and we will continue to press people in the Administration, as we will do in this next panel, to act on some of the suggestions.

I also have a package of statements to put into the record without objection. The ranking Republican asked me to put in the statement from the HOPE NOW Alliance, and we also have, from the Home Ownership Preservation Foundation, the National Council of La Raza, the Brennan Center for Justice, and the PICO Network of faith-based community improvement organizations. And I note that one of those—that one—comes from people in Massachusetts, in New Bedford, Fall River, and Brockton.

So, without objection, they are all part of the record.

And the panel is dismissed with our thanks for a very useful discussion.

We have to get people to get out and people to set up. Please take the conversations outside so we can get the panel going. No one should be standing still. They should either be walking or sitting.

We will now turn to our second panel. We appreciate the attendance of the public officials who are responsible. And I did not follow the usual procedure of asking the public officials to testify first. It is not out of any lack of respect for their commitment and integrity, of which we are appreciative. But it did seem to me that today, it would be very useful if we heard some of the questions and criticisms first, and could then have them respond to them.

I ask people at the door to please leave.

And we will now begin with Herbert Allison, who is the Assistant Secretary for Financial Stability at the Department of the Treasury.

Mr. Allison?

STATEMENT OF HERBERT M. ALLISON, JR., ASSISTANT SECRETARY FOR FINANCIAL STABILITY, U.S. DEPARTMENT OF THE TREASURY

Mr. ALLISON. Chairman Frank and members of the committee, thank you for the opportunity to testify today about the Treasury Department's comprehensive initiatives to stabilize the U.S. housing market and support homeowners.

The Administration has made strong progress ramping-up the Making Home Affordable Program. But even though the number of homeowners being helped continues to grow, we recognize that the Home Affordable Modification Program, or HAMP, faces challenges in converting borrowers to permanent mortgage modifications, and in fostering effective communications between servicers and borrowers.

Our most immediate challenge is converting trial mortgage modifications into permanent modifications. Servicers report that about 375,000 trial modifications will be more than 3 months old, and due to be decisioned before December 31st.

Treasury has launched an aggressive conversion campaign to increase the number of permanent modifications. We have streamlined the modification process, and required conversion plans from the seven largest servicers. Treasury and Fannie Mae have assigned teams to work with each servicer, and to report daily on their progress. We are engaging all 81 HUD field offices and hundreds of State and local governments in this effort.

We have enhanced our Web site to provide borrowers with a simplified way to navigate the modification process, using instructional videos, downloadable forms, and an income verification checklist. Next week, we will hold our 20 borrower event, connecting servicers, housing counselors, and homeowners. In addition, we have brought in executives from the services 4 times to Washington, including just yesterday, to discuss ways of accelerating conversions.

Another challenge is helping unemployed homeowners. HAMP is designed to enable many unemployed homeowners to participate. Borrowers with 9 months or more of unemployment insurance remaining are eligible to include that income for consideration in their modification request.

We recognize, however, that some unemployed borrowers will have trouble qualifying. Treasury is actively reviewing various ideas to improve program effectiveness in this area, while remaining focused on helping borrowers as quickly as possible under the current program.

A third challenge is preventing foreclosures of homeowners eligible for HAMP. During the modification trial period, any pending foreclosure sale must be suspended. And no new foreclosure proceedings may be initiated. We prohibit foreclosure proceedings until the borrower has failed the trial period, and has been considered and found ineligible for other foreclosure prevention options. We are working with stakeholders to review, improve, and monitor compliance with our rules, so no borrower being evaluated for HAMP is subject to foreclosure during that process.

A fourth challenge is transparency. On August 4th, our public monthly report began including trial modifications by each servicer. October's report added data on trial modifications by State. Upcoming reports will show permanent modifications by servicer, and measures of servicer's responsiveness to borrowers. We are requiring servicers to send notices that clearly explain to borrowers why they did not qualify for a HAMP modification, and how they can ask for a second look at their application.

We will also provide additional transparency of the net present value, or NPV model, a key component of the eligibility test. We are increasing public access to the NPV White Paper, which explains the model's methodology. We are also working to increase transparency of the NPV model, itself, so counselors and borrowers can better understand how the model works.

HAMP is on track to provide a second chance for up to 3 to 4 million borrowers by the end of 2012. Based on a recent survey of

servicers, we estimate that, as of the beginning of November, up to 1.5 million homeowners were eligible for the program, meaning they were both 60-plus days delinquent, and likely to meet the HAMP requirements.

To put the current stage of HAMP in context, we should compare the 1.5 million eligible homeowners to the more than 680,000 borrowers who are in active modifications, and are included among the 900,000 borrowers who have received offers to begin trial modifications. On average, borrowers and trial modifications have had their payments reduced by over $550 per month, down roughly 35 percent from their prior payments. HAMP has made great strides since modifications began in May. But we have a long way to go. We will continue to work closely with housing counselors, State and local governments, servicers, homeowners, investors, and Congress to enhance the program's performance, and to help keep Americans in their homes. Thank you.

[The prepared statement of Assistant Secretary Allison can be found on page 58 of the appendix.]

The CHAIRMAN. Next is Mr. Krimminger.

STATEMENT OF MICHAEL H. KRIMMINGER, SPECIAL ADVISOR FOR POLICY, OFFICE OF THE CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC)

Mr. KRIMMINGER. Chairman Frank and members of the committee, thank you for the opportunity to testify on behalf of the FDIC about the private sector and government response to the mortgage foreclosure crisis.

Mortgage credit distress and declining home prices have been fundamental causes of uncertainty. Structurally unsound mortgages and historic home price declines, which precluded refinancing, have led to unprecedented increases in mortgage defaults and foreclosures.

Chairman Bair recognized the problem early on, and strongly advocated for a program of systematic modifications in 2007. Her proposal rested on a central premise. Simply, foreclosing on defaulted loans would only add to the excess supply of housing, push down home prices, and make the mortgage credit problem worse. Where a sustainable modification can be achieved that reduces losses compared to foreclosure, it is only good business to modify the loan.

Unfortunately, the crisis has shown that the large-scale modification effort that we need is hampered by contradictory incentives in securitization, inadequate resources, and, far too often, a failure to take action with new approaches to working with borrowers.

In 2008, the FDIC needed to implement these principles advocated by Chairman Bair when it was named conservator for IndyMac Federal Bank, which had tens of thousands of delinquent mortgages on its books. The goal of the FDIC's loan modification program was to achieve the best recoveries possible by converting distressed mortgages into performing loans that were affordable and sustainable over the long term. To date, almost 24,000 borrowers have received a modification through this program.

The problem nationwide, however, is immense. While some servicers have been effective, much more must be done. Last fall, the FDIC issued a guide to implementing streamlined loan modi-

fication programs which we call "Mod in a Box," to spur servicers in applying similar modification programs.

Earlier this year, the FDIC applied its practical experience in loan modifications in working with Treasury and other agencies on recommendations for the Home Affordable Modification Program, or HAMP. The FDIC supports HAMP as part of the solution.

In addition, we continue to remain open to new approaches that may be necessary to respond to the scope and changing character of the mortgage problem.

Our loss sharing agreements for failed banks require either the FDIC mod program or HAMP. Here, too, we have continued to push for innovative responses. For example, we have urged temporary forbearance for borrowers who lose their jobs in the recession. We also will provide loss share incentives to support principal write-downs to maximize net values.

The FDIC's experience has provided a number of lessons learned that we would like to share with the committee, and I would like to emphasize one key point: mods make good business sense, and help consumers where they maximize recoveries on troubled loan mortgages.

First and foremost, early communication in modification efforts give the best chance of success. Success is much more likely if you contact the borrower early, give a specific mod offer, and complete the mod before an extended delinquency. Effective communication with borrowers requires an effective information technology infrastructure, thorough staff training, and a consumer support or consumer service focus.

Second, the more affordable the modification, the lower the redefault rate. Until recently, far too many mods actually increased the monthly payments. No wonder they often failed. We also must address second liens as part of the affordability question.

Third, close working relationships with HUD-approved counseling groups improve borrower response and modification success. Nor surprisingly, counselors have much more credibility with borrowers.

Fourth, lenders and servicers must be flexible to address new challenges. Problems caused by job loss or deeply underwater loans will require lenders and servicers to employ new approaches.

Finally, modification programs should be kept as simple as possible, so that servicers can apply a streamlined approach, and borrowers can understand their options.

Throughout the financial crisis, the FDIC has worked closely with consumers and many others to reduce unnecessary foreclosures and the devastating consequences they impose on our communities. Loan modifications, refinancing, temporary forbearance for out-of-work borrowers, and principal reductions are all tools to achieve these goals.

We continue to support Treasury's HAMP as a major part of the solution. But we all know that we must remain open to new approaches to respond to growing unemployment and increasing numbers of underwater loans. Above all, the FDIC remains committed to achieving our core mission: protecting depositors and maintaining public confidence in our financial system. Thank you

for the opportunity to testify today. And I would be happy to take any questions.

[The prepared statement of Mr. Krimminger can be found on page 95 of the appendix.]

The CHAIRMAN. And finally, Mr. Douglas Roeder.

STATEMENT OF DOUGLAS W. ROEDER, SENIOR DEPUTY COMPTROLLER FOR LARGE BANK SUPERVISION, OFFICE OF THE COMPTROLLER OF THE CURRENCY (OCC)

Mr. ROEDER. Chairman Frank, and members of the committee, on behalf of the Comptroller of the Currency, I appreciate the opportunity to discuss the state of national bank residential mortgage modification efforts.

I am the Senior Deputy Comptroller for Large Bank Supervision at the OCC. Many of the large banks supervised by the OCC are major mortgage servicers, so we have direct supervisory experience with the actions they have taken, and the issues that present challenges to sustainable mortgage modifications.

In 2008, as part of our oversight, we initiated the mortgage metrics project to gain comprehensive, reliable, and comparable data on the performance of mortgages serviced by national banks. Our mortgage metrics report, which is based on validated data from 34 million loans, assesses the performance of mortgages and various foreclosure mitigation strategies, including detailed information regarding loan modification efforts. It is a valuable tool that helps us focus our supervisory actions based on validated data.

For example, in March 2009, in response to high redefault rates on modifications, we directed the largest national bank servicers to review their modifications and policies for future modifications to improve their sustainability. Subsequent to that direction, we have seen both the volume and quality of loan modifications and payment plans improve.

During the second quarter, home retention actions—payment plans and loan modifications—increased by more than 20 percent. We are still finalizing our next report, but we expect an even greater increase of nearly 70 percent in the third quarter.

Actions taken under the Administration's Home Affordable Modification Program represent a portion of homeowner assistance provided today. National banks also help homeowners through programs that do not require taxpayer-supported incentives. Between January 1, 2008, and June 30, 2009, national banks and thrifts implemented more than 1.8 million home retention actions. Of these, less than 115,000 were made under HAMP. HAMP numbers increased in the summer and fall of 2009, but still represent only a portion of national banks' homeowner assistance efforts.

In addition to the increasing volume, the character of home retention actions is changing. More than 78 percent of modifications made in the second quarter of 2009 reduced borrowers' monthly principal and interest payments. As a result, delinquency rates subsequent to modification are improving in more recent vintages. Improving sustainability of modifications and returning borrowers to a positive cash flow reduce eventual foreclosures, provide homeowners an opportunity to keep their homes, and minimize losses to banks and investors.

The OCC fully supports servicer participation in HAMP and the Administration's second lien modification program. But regardless of the types of programs implemented, national banks have an obligation to ensure that their regulatory reports and financial statements accurately and fairly represent their financial condition.

On Monday, we issued guidance to our examiners stating that we expect banks to follow generally accepted accounting principles, and maintain adequate allowance for loan and lease losses, regardless of whether a loan is modified. Adherence to sound underwriting practices, including adequate documentation of borrower's qualifications for and ability to repay a modified mortgage is also essential.

While home retention actions are improving, we hear too many consumer complaints of lost paperwork, bad guidance, long waits, and difficulty in simply contacting servicers. The volume of complaints is unacceptable. We have directed national banks to improve operational efficiency to keep up with volume, improve their internal processes, and answer their customers' concerns accurately and promptly.

As a part of our ongoing supervision, our examiners assess banks' complaint resolution processes, and require corrective action for identified deficiencies. At the same time servicers need to improve operations, other factors contribute to the low number of HAMP trial plans being converted to permanent modifications.

Servicers report consumers often fail to provide necessary and verifiable documentation of ability and willingness to repay their debt. In some cases, loans are already considered affordable under HAMP's 31 percent debt-to-income guideline. In other cases, borrowers cannot demonstrate a valid financial hardship. Increasingly, the financial condition of many borrowers has deteriorated so far that it is not possible to modify a loan and meet HAMP's net present value requirement.

While HAMP and other programs show progress, we must be realistic about the continuing effects of high unemployment and depreciated home values. These macroeconomic factors weigh on the performance of the residential mortgage portfolio, and they drive delinquencies and foreclosures. In these difficult economic conditions, effective loan modifications will be an important tool to help responsible homeowners avoid preventable foreclosures.

But they will not help everyone. As a result, we will see further deterioration in loan performance in the months ahead. My written testimony provides additional detail on these issues.

Again, I appreciate the opportunity.

[The prepared statement of Mr. Roeder can be found on page 119 of the appendix.]

The CHAIRMAN. All right. We will now take a recess and return. And then, the gentlewoman from California will be presiding, and we will have a chance to ask some questions. I appreciate your staying with us.

[recess]

Ms. WATERS. [presiding] The committee will come to order. Having heard from our witnesses, I will recognize myself for 5 minutes for questions.

Mr. Allison, the Honorable Herbert M. Allison, Jr., Assistant Secretary for Financial Stability, U.S. Department of the Treasury, I did have an opportunity to hear your testimony. And I heard you describe the efforts that have been put forth by the Treasury to talk with the servicers, and to encourage them to do better.

Mr. Secretary, don't you think that's a waste of time?

Mr. ALLISON. Well, Congresswoman Waters, thank you very much for your question, and for your tremendous interest in this program.

And, no, we don't think it's a waste of time. We have seen—first of all, let me say again, as I said in my testimony, we are not satisfied yet with how this program is unfolding. We still have a lot of work to do. The servicers have a lot of work to do. And we are holding them accountable for their performance.

I think we have to look at this program in stages. In the early stages, our main emphasis was on bringing in as many people as possible to this program to help keep people in their homes. Now, the real challenge is to migrate them from trial modifications to permanent modifications. And—

Ms. WATERS. Excuse me, if I may—

Mr. ALLISON. Yes, ma'am.

Ms. WATERS. But you have not been doing that. We have people who have been in trial modifications, and somehow we can't get them into permanent modifications. It doesn't appear to be working very well.

Mr. ALLISON. And to date—you're absolutely right. We are not satisfied with that, either. We have a relatively low number who are in permanent modifications. That's why we brought the servicers—

Ms. WATERS. And, again—

Mr. ALLISON. Yes, ma'am.

Ms. WATERS. —if I may interrupt—

Mr. ALLISON. Yes.

Ms. WATERS. —because, you know, I just have to get this out of my head—

Mr. ALLISON. Please.

Ms. WATERS. —you have modifications going on. You have foreclosures going on while people are supposedly in modifications. What are you doing about that?

Mr. ALLISON. Well, actually, as I mentioned, these servicers are prohibited under this program from foreclosing on people—

Ms. WATERS. But it's a voluntary program. So if they don't do it, what do you do?

Mr. ALLISON. We can take actions, such as—

Ms. WATERS. Such as?

Mr. ALLISON. Such as not paying them, such as clawing back prior payments, such as—

Ms. WATERS. You think that $1,000 is going to be a deterrent?

Mr. ALLISON. Well, I think what also helps here, Congresswoman Waters—and we totally agree with you, that we have to take whatever actions we can to assure that they are going to make these modifications permanent. So we have, right now, a program where we're in with the servicers in their offices where they're doing the modifications, to watch exactly what they're doing.

We have Freddie Mac, who is auditing this process. We are publishing monthly reports on each servicer's performance. We are going to be expanding those reports to deal with how rapidly they are achieving modifications. We have targets for every one of them, which we outlined again yesterday, to make sure that, where they have all documentation, they will complete those modifications, or at least the decisions on the modifications, by the end of this month.

And about a third of these trial modifications are ones where the servicers already have all the documentation.

Ms. WATERS. Okay.

Mr. ALLISON. So there is no excuse for them not to complete—

Ms. WATERS. Well, we appreciate that. However, these foreclosures have been going on for a long time now.

Mr. ALLISON. Yes.

Ms. WATERS. An awful lot of people have lost their homes. And while we appreciate the stages of—people are out of their homes.

Mr. ALLISON. Yes.

Ms. WATERS. And so, we are concerned about principal reduction, for example. What have you done about—

Mr. ALLISON. Yes.

Ms. WATERS. —principal reduction?

Mr. ALLISON. Well, you know, what is not widely understood—and I think we have to do a better job of communicating this—is that from day one, last March, in our guidance for the servicers, we allow them to reduce principal as the first step in a mortgage modification—

Ms. WATERS. But they don't do it.

Mr. ALLISON. Well, we are dealing with that now. And we are talking with the servicers about the need to take a broader view of what is the best solution for each homeowner. And for some, it can be a principal modification at the outset, or a combination of principal modification and interest reduction.

So, that's another area that we're going to be looking at, is are the servicers looking broadly enough at what the potential solutions are for each homeowner.

Ms. WATERS. Quickly, let me just say to FDIC, Mr. Krimminger, we—Barney Frank and I—signed a letter to the Administration, because we were very pleased when you took over IndyMac, and the way that you did loan modifications. And we thought, at that time, somehow it should be organized in ways that you guys should be in charge of the loan modification program.

Can you identify for us what you have discovered that really works? Don't you have some ideas about how we could do this better? I hope all of the agencies are talking to each other, and you have had some opportunity for input. But it's not evident. What would you advise? What have you done to make these loan modifications real? What should be done?

Mr. KRIMMINGER. Well, thank you, Chairwoman Waters. We appreciate your support on this. We do support Treasury's following up with the HAMP program to make sure that it works. Certainly, there are times—and I think this is clearly one of them, and I think Treasury agrees—for innovations and innovative thinking. We have provided recommendations to Treasury in the develop-

ment of HAMP. As you may know, the HAMP itself includes a waterfall of options which were really modeled on the ones that we used at IndyMac.

I think the lessons that we learned at IndyMac—and are working to implement even more so in HAMP—include things like, early on, getting a dollar amount of the modification into the borrower's hands, making sure that, if possible, you're able to get the information to begin the verification of income immediately, the first payment from the borrower, as well as a signed agreement, so that the borrower knows what their obligations are. We think it's very important to have very continuous and very early contact with the borrowers to really make these programs work.

One of the things I think that servicers are learning now that they may not have understood fully is the need for a real refocus of the servicer's whole loss mitigation process away from collections, much more to a consumer-oriented type of process, so that you reach out to borrowers. Also, servicers should be utilizing much more the counseling groups, HUD-approved counselors. We found that to be a very effective tool at IndyMac.

Ms. WATERS. Let me just interrupt you for a moment. As I understand it, one of the things that you did was you sent out notices to the borrowers, and you showed them in the notice what you could do for them.

Mr. KRIMMINGER. Right.

Ms. WATERS. For example, when some of the servicers—when the notices went out early on, when we first started doing the modifications, it would ask people to come in. "We want to talk to you." And people said, "Uh-uh, I'm not going in, because I know they want to tell me they're going to take my home."

But when you send out a notice that says, "You owe X amount of dollars on your loan, and we have a loan modification program that could help you reduce that loan by some percentage, and this is how it works," or something, that you get more people responding. Is that true?

Mr. KRIMMINGER. That is absolutely true. We have had a response rate with providing those types of notices to people with an actual dollar amount of the new modification amount of around 70 percent, which is very high for the industry. That was one of the biggest lessons we learned at IndyMac.

Ms. WATERS. Well, has that been adopted by the Administration, or the banks, or the servicers, or anybody as a way by which to get people coming in to talk to you about a loan modification, and not being afraid that this notice is only simply to take away their homes?

Mr. KRIMMINGER. I will have to defer to Secretary Allison, but I believe a number of servicers have begun to adopt that approach. But some have not.

Ms. WATERS. Well, Mr. Secretary, why haven't you included something like that?

Mr. ALLISON. Well, actually, the servicers are reaching out in a much more effective way today. The—

Ms. WATERS. No, I asked something specific. This notice that they learned to use at FDIC that said, "This is what we can do for

you," has that been adopted as a practice, as a way of encouraging participation?

Mr. ALLISON. Well, they have sent out more than 900,000 offers to homeowners with the terms, in many cases, indicated. And, therefore, people have an opportunity to see what the benefit for them will be from participating in the modifications. I think that the outreach is going much better than it was.

The challenge now, as I mentioned, is to convert these trial modifications, where people are benefitting. We have almost 700,000 people who have received reductions in their monthly mortgages, on average, of $550. So we have all those people benefitting today. The issue now is to convert them to permanent modifications, so those benefits continue.

Ms. WATERS. Well, you're right. That's a big issue, a huge issue.

Mr. ALLISON. It is.

Ms. WATERS. And I want to thank you. I have more than used up my time. And I am now going to yield to the gentlelady from—

Mrs. CAPITO. West Virginia.

Ms. WATERS. West Virginia, I have been there, I should know that. Ms. Capito?

Mrs. CAPITO. Thank you. I would like to thank the panel. I'm sorry if I missed your testimony, but I have certainly read through most of it.

One of the questions that I think is complicating this issue that we haven't really—and I'm interested to see what kind of innovations you're working on, how you're addressing the issue of a second lien. Most people who are in danger of being foreclosed upon have probably run their credit cards up as high as they can to keep the payments going. They have a home equity loan going. They have other issues with their finances. And I know the second lien issue has been complicating these loan modifications.

Could Secretary Allison talk about that? Or any of the rest of you? I would be interested to hear your ideas on how we get through that issue.

Mr. ALLISON. Thank you very much, Congresswoman Capito. Yes, that is a real concern. And I know that this week—and perhaps Mr. Roeder could talk to this—the OCC is issuing guidance to the banks on how to deal with the accounting for second liens. And that's a major step, we think, toward coming up with a more comprehensive solution for homeowners who have both a first and second lien.

And, obviously, there is going to be a need, too, in cases where one bank may hold the first, and another hold the second, for some type of a clearinghouse, so that banks can find out who has the other mortgage on a particular homeowner's house.

Mrs. CAPITO. Wouldn't they—

Mr. ALLISON. So that they can come up with a unified solution for that particular homeowner.

Mrs. CAPITO. Is that—is the borrower—when the documents that they're required to bring in to get the permanent modifications, do they bring in the documentations for what other liens they would have on that property? Certainly that would be a part of that. Is that correct?

Mr. ALLISON. I don't know that in all cases they are, at least initially. The requirements for HAMP are to provide information about income, about residence, the hardship affidavit, and so forth.

But I think that servicers that are doing a thorough job are inquiring about the overall financial position of the homeowner.

Mrs. CAPITO. Mr. Roeder, did you have a—

Mr. ALLISON. But—

Mrs. CAPITO. I'm sorry.

Mr. ROEDER. Yes, a couple of points dealing with your question.

First, on the examiner guidance, we sent the guidance to examiners. We didn't send it to the industry. The reason is, with this modification effort being so significant, we many times will go to our examiners with guidance. We have asked the examiners to share it with their banks. But it's not a broad distribution. We're dealing with a fairly focused group of institutions.

So, it was examiner guidance, not banker guidance. But we did share it with the bankers, so they are aware of our expectations. And that guidance was simply to remind and clarify for our examiners that GAAP and existing supervisory policies should be followed in working with bankers to ensure that the accounting and the asset quality assessments being done are done in accordance with safe and sound banking. So that's one piece.

On the second lien issue, one of the things we don't hear from the servicers is that there is an inhibition to modify the first mortgage when there is an existence of a second. Early on in the crisis, that was more of a prevalent comment. We don't hear that from the servicers directly. The focus in most cases is getting that first mortgage modification done, and not worrying about the second.

To Mr. Allison's point, there is a complication here. Sometimes the servicer who is doing the mod on the first, and the bank that's holding the second may be different parties. And—unless it's surfaced by the borrower or some other means—there is not a good mechanism to clearly know that servicer "A" has a mortgage and servicer "B" has a second lien, and they should hook up.

What we have asked examiners to be mindful of is that everything they should do—if they're holding that second lien, and they're not in a position where the bank is also the first lien holder doing the mod, they have to do their best in their process to ensure that they have done diligence to seek the existence of that first lien, and appropriately account for that second lien and the risk in that, assuming that there was a mod done on the first.

If there is not a mod done, they still have the responsibility to make sure that the accounting and the reserve and provisioning is accurate, given potential risk in that portfolio, alone.

We don't see the servicers complaining that they're inhibited to do a first when there is an existence of a second.

Ms. WATERS. Thank you very much. Mr. Green?

Mr. GREEN. Thank you, Madam Chairwoman. I thank the witnesses for appearing.

Friends, I sincerely believe that Dr. King was right when he said, "knowing that the arc of the moral universe is long but it bends toward justice." And I believe that President Kennedy was right when he said, "here on earth, God's work must truly be our own."

You three fine men, in my opinion, are doing God's work today. And, as such, you have an opportunity to make a difference in the lives of people that you will never meet and greet.

So, I start by asking you this: Are you familiar with the term, disparate impact? You are. And I will ask you, Mr. Allison, just for the record, tell us what this term means.

Mr. ALLISON. It impacts more on some segments of society than on others, for example.

Mr. GREEN. All right. That's an acceptable definition, I believe.

Now, with reference to the foreclosure crisis, is there a disparate impact?

Mr. ALLISON. Yes, sir. There is.

Mr. GREEN. Tell us the sector or segment of society that is experiencing the disparate impact, please.

Mr. ALLISON. People who are in lower-income communities, I think, have been more devastated by this crisis, even than the average American.

Mr. GREEN. Define for me who these people are who are most likely to be in the lower-income communities.

Mr. ALLISON. Most often they are minorities, African American, Latinos—

Mr. GREEN. Define minorities, please. Say again.

Mr. ALLISON. African Americans and Latinos, for example.

Mr. GREEN. Hold your point for just a moment.

Mr. ALLISON. Yes, sir.

Mr. GREEN. Let's go to our next person who is going to bend the arc of the moral universe toward justice. Do you agree with what Mr. Allison said?

Mr. KRIMMINGER. Absolutely. There is clearly evidence that there is a disparate impact upon lower-income and minority communities.

Mr. GREEN. Define minorities.

Mr. KRIMMINGER. I would define it in terms of ethnic minorities, such as African Americans.

Mr. GREEN. Define ethnic minorities.

Mr. KRIMMINGER. African Americans, Latinos, and other ethnic minorities, in particular.

Mr. GREEN. Let's go to our next forger of justice. Do you agree with your two colleagues?

Mr. ROEDER. Yes, I agree there is a problem.

Mr. GREEN. Now, assuming that we do 100 percent of what has been called to our attention, that we are as efficacious as humanly possible, will this negate the disparate impact that we are discussing currently?

Mr. ALLISON. I don't believe that these programs, by themselves, are going to negate the disparate impact on those communities.

Mr. GREEN. Thank you.

Mr. KRIMMINGER. No, because when we were doing work at IndyMac, I have seen communities throughout southern California that are already dramatically impacted. So, even what we do in the future won't affect those who have already been affected.

Mr. GREEN. Thank you.

Mr. ROEDER. And I would agree with that. There is much more work that needs to be done. We are not anywhere near the solution.

Mr. GREEN. If we are going to bend the arc of the moral universe toward justice, and if, here on earth, God's work must truly be our own, would you agree that we must and should do more to negate the negative disparate impact, the invidious impact that is being felt on some communities? Do you agree that we should do more?

Mr. ALLISON. I fully agree.

Mr. GREEN. Yes, sir?

Mr. KRIMMINGER. I would concur.

Mr. GREEN. Yes, sir?

Mr. ROEDER. And I agree.

Mr. GREEN. Do you agree that a way can be forged if we have the will to do it, that a way can be found to negate this disparate impact? Mr. Allison?

Mr. ALLISON. Yes, sir, I do.

Mr. KRIMMINGER. I do, yes. There are difficulties, but there are ways to overcome difficulties.

Mr. GREEN. Mr.—

Mr. ROEDER. And I agree. There are challenges, but you have to keep going after it.

Mr. GREEN. Now, the ultimate question becomes this. Given that we acknowledge the condition, if we use a scientific approach, given that we acknowledge the condition, and given that we know that a solution can be forged, what are we going to do about it?

What will we do, beyond using the rising tide raising all boats theory, which we find fatally flawed, as it relates to some who don't have boats, and who have boats that are not seaworthy? What will we do? Mr. Allison?

Mr. ALLISON. Congressman Green, I think, first of all, we have to recognize that this is a real problem.

Mr. GREEN. Yes, sir.

Mr. ALLISON. And we have to focus on it.

Mr. GREEN. Yes, sir.

Mr. ALLISON. And devote ingenuity, and I think—

Mr. GREEN. Do this for me.

Mr. ALLISON. Yes, sir.

Mr. GREEN. My time is almost—listen, you're excellent, and I appreciate what you have said, all three of you. But when you say "we," define we. You said, "We have to focus." Not putting you on the spot, but we need, for the record, to define these things. Who is the "we" that should focus, please?

Mr. ALLISON. Well, Congressman Green, I would first start with the American people as a whole. Also, there are government representatives and people in the Administration, for example, who are working very hard to make sure that, with this program, we are reaching people who need it the most. And that's why we're working with State and local officials, and also community groups, as well as counselors, to reach the areas most affected. And many of those, of course, are minority communities.

Mr. GREEN. My time has expired, and I thank you, Madam Chairwoman. I will not be impolite and encroach on the time. Thank you.

Ms. WATERS. Thank you very much. Mr. Cleaver?

Mr. CLEAVER. Thank you, Madam Chairwoman. To Mr. Allison and Mr. Krimminger, I don't think either one of you are the—none of the people at the table are the villains here. I think you represent agencies that are probably not fulfilling their responsibilities.

Do you believe that the mortgage companies and the banks are doing the best they can?

Mr. ALLISON. Congressman Cleaver, I think the banks have a long way to go to get up to their full potential to help alleviate this problem. They have been making progress, to be fair.

We have people from Treasury and from Fannie Mae in the offices of the top seven servicers right now. They are stationed there, working with them, finding the facts about why this program isn't working even better. We are not satisfied, by any means. They are on notice that we are not.

We intend to publish more and more information, as fast as we can, reliable information about their performance, so the public and the Congress can judge for themselves.

Mr. CLEAVER. Well, your—

Mr. ALLISON. Much more has to be done.

Mr. CLEAVER. Well, yes. We have, legislatively and administratively, forced them to work with homeowners who are in trouble. We forced the lion to lie with the lamb. But if you look closely, when the lion gets up, the lamb is missing. And we are saying, "Here, kitty, kitty."

What I think needs to happen is something needs to happen to the lion. I wrote down a quote one of you said, "We are reaching out to the banks." You are reaching out—most of us are outraged.

If a homeowner does not comply with the requirements of the mortgage company, they lose their home. If the mortgage companies don't comply with the requirements of Congress, what do they lose? Any of you?

Mr. ALLISON. If I may try to respond to your question, Congressman Cleaver, first of all, we do have some financial remedies that we can apply to these servicers. One is we can deny them payments. We can claw back prior payments if they are not seen to be following the rules of the program.

I think what's extremely important is to shine a light on the performance of each one of these banks, and that's exactly what we are doing.

I think that one has to also recognize that the servicers, until this year, were in the business of collecting payments and foreclosing on people. They are having to change their entire business model. They have to engage with homeowners. They have to help homeowners. This has required them to change their systems, to retrain their people, to hire more people.

They have moved in that direction. They have to do much more. And we are constantly pushing them in every way possible to do the best possible job.

Mr. CLEAVER. Yes, but maybe the system of pushing is not working. I have twin boys. And I found out early on that if I spanked one of them when they were doing something, the other would straighten up. The other one—you know, it had an impact on the

other. I just think in this situation, we haven't spanked anybody. So I think they have come to the conclusion that spankings are not on the agenda.

I don't miss hearings. I am here. We are here.

Mr. ALLISON. Yes.

Mr. CLEAVER. I have been to a lot of these hearings. We have asked a lot of these questions over and over and over again. We have had that table packed with witnesses, and witnesses sitting behind them. We go through this over and over again. And I have to tell you that, as we move through this holiday season, this will be the second holiday season that I have been asking these questions, that we have been asking these questions. Nothing has happened.

Why can't something happen to these lending institutions who took taxpayer money? They took our money. And they are—and we are talking about, well, we are—you know, we're issuing guidance, and we are reaching out to them, we are giving them some Coke and some water, and why can't we do something to one of them? And I think everybody—excuse me.

You know, I was approached last night by somebody who is about to lose his business because the bank is now requiring more of him. And I am frustrated. And I get even more frustrated because you guys can't say, "The next time we find somebody who is not doing their job, we're going to come back and recommend that the money be taken from them, the TARP money." Thank you, Madam Chairwoman.

Mr. ALLISON. May I answer you, Congressman Cleaver? Let me talk very straight about this. We have worked with them to try to get them up-to-speed. We have Freddie Mac auditing their performance. Are they following the rules? Are people being denied a mortgage modification who should get one under the plan?

And, as we move forward, we are putting them on notice. And then we will exact penalties of them, and be publicly outspoken about who is performing well and who is not. And you're absolutely right. We have to—we are going to move to the point where we are disciplining the banks if they don't perform better than they are today. While they are getting better, it's not nearly good enough, and it's not fast enough.

We have given them clear targets for how many mods they have to make permanent by the end of this year. And in every case where they have existing documentation, there is no excuse for not getting that mod done by the end of the year—at least from their standpoint, deciding whether to make the mod or not.

Ms. WATERS. Mr. Scott?

Mr. SCOTT. Yes. Let me ask a couple of questions. In the program, why can't we stop foreclosure proceedings while the modification is going on?

Mr. ALLISON. Congressman Scott, the way the program works today is that the servicers are prohibited from foreclosing during the process. And we are enforcing that, and we are auditing that, to make sure that they do comply.

The question you're asking, though, I think goes beyond that, which is, why don't we simply stop the entire foreclosure process? We have formed a group, a council, composed of foreclosure attor-

neys, as well as government officials and others with an interest in this problem, to try to see what more we can do to help avoid people being frightened by a foreclosure process underway, at the same time that they're being considered for a modification. And there is no doubt that this is confusing people, and scaring them unnecessarily.

So, I think we have to find a better way of dealing with the problem that you are rightly pointing out.

Mr. SCOTT. To be clear now, my information says to me that the foreclosure proceedings are continuing to go ahead, even while the modification is going forward. That's not an accurate statement?

Ms. WATERS. It is.

Mr. ALLISON. I think that is the case—

Mr. SCOTT. Yes.

Mr. ALLISON. —that there may be a procedure underway at the same time as a person is being considered for a mod. That is the issue that we need to engage further about. Right? And to see whether more can be done to provide assurance to the homeowner that the first priority is to modify that loan.

Mr. SCOTT. All right. Here are the major complaints with the program.

First of all, it includes, one, a lack of transparency about the criterion, the net present value test used to evaluate borrowers' eligibility, the lack of capacity of servicers to process loan modification requests on a timely basis. There is nobody there to respond in the person of a live person. There is no—in this most critical, this most essential of needs, a family going through the process of losing their home, even at the extent of calling, they get a computer.

And the people most affected are the people at the middle to lower economic—and lower economic extreme. And they get a recording, no live person, and in cases where the foreclosure action is taking place while the homeowner is going through the HAMP approval process.

So, Mr. Allison, I think we have to come to the conclusion that that is an area that we need to address, that we need to address that area in at least stopping the whole foreclosure procedure until we're going through. Does that require legislative action on our part? Is it something that you all can do? This program, in order to be effective, should do that.

Now, my other question. Another area. We use the 31 percent. Now, how did we arrive at 31 percent? Thirty-one percent of a monthly income is the criterion for this program. In these tough economic times of soaring unemployment where, in fact, that monthly income, in many cases, goes to zero, is it practical not to be able to have an adjustment factor in there, where we can lower that 31 percent threshold?

Mr. ALLISON. Thank you, sir. Thank you for those questions, Congressman Scott. Let me try to go down the list, one by one.

In terms of lack of transparency of the program, we are making more information every available every month in our monthly reports. We are also publishing information on makinghomeaffordable.gov.

With regard to the NPV tests, we intend to make the NPV model available to counselors in the first quarter of next year, and—which

is coming up very soon, so that they can see how the model works, and work with homeowners to see whether they would qualify. Now, this is a complex issue, and we want to make sure that people are properly acquainted with how to use the model. But we intend to make that model available to them. And I think that will be a big step forward.

In terms of the capacity of the servicers, we are looking at the relative capacities of the different servicers, comparing them, seeing who is doing the better jobs, what their capacity is, how many people they have devoted per eligible mortgagee, so that we can work with them on best practices to ramp up their capacity, and to have standards for what their capacity needs to be.

In terms of no live person answering the phone, I think that has been a real problem. People can go to makinghomeaffordable.gov, they can look at our hotline. They can call our hotline if they need to get a person on the phone to work with them. And we can work with the servicers to make sure that they are being heard.

In terms of facilitating—of foreclosure actions taking place while the person is still up in the air about whether they're going to have a mod or not, as I mentioned before, we have convened a group to work on that issue.

Now, foreclosures can't take place before people have a decision about their MHA modification. Nonetheless, they're concerned that the process may be going forward while they're being considered. That is the issue where we want to work with servicers, and see what more can be done to provide more assurance to people that they are going to be considered.

And lastly, and very quickly, on the 31 percent debt to income ratio, and the fact that many people now are unemployed, they don't have income, the program today provides that if they have at least 9 months of unemployment insurance coming their way, they can qualify for a mod if all the other qualifications are met.

Nonetheless, as I said in my testimony, there are many people who won't be able to qualify because they have lost their jobs. So what can we do, and what can the servicers do for them? That's something we are looking at now, and we are exploring different alternatives, such as the Pennsylvania model and others, to see whether there is more that might be done. Some of this might require legislation, however.

Mr. SCOTT. All right. Thank you.

Ms. WATERS. Thank you very much. I request unanimous consent for 1 minute for a closing on this, because I think it's very important that you gentlemen at the table understand that we are very unhappy. Our constituents are in pain. Our communities are at great risk.

Treasury, you're just too slow. You talk about all of the things that you are going to do, how you are going to improve. We have been listening too long.

FDIC, we are appreciative for what you have shown can be done. I don't know who is talking to whom, but it appears to me that some of the advice that the FDIC should be giving to others who are involved in trying to deal with this foreclosure issue is advice that needs to be shared. It doesn't appear that it's being looked at.

And for OCC, I don't get a real sense of what you do. You do advisories. You look at what has or has not been done, and then you issue information that says what should be done, or what could be done. This is not good enough.

And we did not hear a lot—do you know about the legislation tomorrow that we have, H.R. 4173, the Wall Street Reform and Consumer Protection Act? Do you know about what we have in there for the unemployed? Do you support that, Treasury, Mr. Allison?

Mr. ALLISON. Yes, ma'am. In fact, we are working closely with staffs of the various leadership Members in the Congress on that legislation and others.

Ms. WATERS. What about you, Mr. Krimminger, do you support that—

Mr. KRIMMINGER. I—

Ms. WATERS. —legislation that deals with the—that portion that deals with the unemployed?

Mr. KRIMMINGER. I have to apologize to you, Madam Chairwoman. I will have to get back to you on that, because I am not familiar with that specific provision of the bill.

Ms. WATERS. Mr. Roeder?

Mr. ROEDER. Nor am I familiar with that bill, so I cannot comment.

Ms. WATERS. Okay. Well, this is—we are taking a strong look at what we do for people with emergency medical problems, the unemployed.

But what we want to hear from you is what you are going to do to penalize. We want some specifics. We want to know what you are doing to encourage face-to-face involvement with the borrowers and the servicers. We want to know what you are doing about principal write-down. We really do need some creative proposals. We did not hear that.

What we do hear is a lot of talk about how you are going to encourage the banks. The banks thumb their noses at all of us. They don't care about what you're saying. We bailed them out, and they turned around and reduced the credit limits, increased the interest rates, and said, "We will pay you your money back, don't tell us what to do about our bonuses and our payment practices." And so, we are not encouraged at all when you talk about working with them and the servicers to make them do the right thing.

Having said that, the Chair notes that some members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses, and to place their responses in the record.

We thank you, and this hearing is adjourned.

[Whereupon, at 1:59 p.m., the hearing was adjourned.]

A P P E N D I X

December 8, 2009

OFFICE OF CONGRESSMAN CARSON

Statement of Congressman Carson
Financial Services Committee
"The Private Sector and Government Response to the Mortgage Foreclosure Crisis"
December 8, 2009

Thank you, Mr. Chairman, for holding this important hearing today. As millions of homeowners continue to struggle to pay off their mortgages, it is imperative we combat this continuous surge in foreclosures that has pushed property values to new lows and curtailed economic growth. Not only has the foreclosure crisis damaged the financial stability of working families and communities of the residents of the 7th Congressional district of India but has also crippled credit markets and diminished overall economic activity and performance.

With unemployment numbers in the country continuing to be cause for concern and unemployment fast becoming the main cause of the housing crisis, the Administration's current loan modification program does little to help homeowners who have lost their jobs and are facing foreclosure. Days after the Jobs Summit, this issue must be addressed.

Federal promises to protect homeowners are failing. There continues to be an unrelenting wave of foreclosures across the United States. In September 2009 the foreclosure rate in my district was 3.58%. That's an increase compared to September 2008 when the foreclosure rate was 2.78%. The national foreclosure rate for September 2009 was 2.93%, this is also an increased compared to September 2008 when the foreclosure rate was 1.67%.

Currently, a very small fraction of the $75 billion, taxpayer-financed program has resulted in permanent lower payments. Given the relatively low amount of trial modifications that have been undertaken and converted into permanent status, additional incentives are needed, and to that end, I am pleased Treasury has announced plans to revamp the Home Affordable Modification Program. However, under these new plans, I would like to understand how more trial loan modifications will successfully be converted to permanent terms. I would also like to know if there are any plans to help unemployed families pay their mortgages until they can find new employment. Finally, I would like to understand how to prevent the high redefault rates for some loans modified under the Home

Affordable Modification Program. The Treasury can effectively force banks to make more loan modifications, but if homeowners continue to walk away from their properties, the modifications will have little effect on the overall US housing picture.

I look forward to today's testimony.

With that I yield back my time.

December 8, 2009
Statement by the Honorable Kenny Marchant
Committee on Financial Services
Hearing on "The Private Sector and Government Response to the Mortgage Foreclosure Crisis"

Thank you Mr. Chairman for holding this hearing. I'm looking forward to getting some clarification on a few issues. First, my impression of these programs from talking to my constituents is that they aren't working. The Treasury continues to trumpet the number of 'trial modifications', but the truth is very few of the modifications are sticking. At each stage of the modification process, the amount of loans advancing to the next level drops off dramatically. Especially disturbing is the amount of re-defaults in the loans that receive these trial modifications—between 30 and 45 percent.

There are several very good reasons for this.

First, if a borrower doesn't have a job, he or she will obviously never be able to pay for their mortgage. A little more focus on creating **private sector** jobs and a little less brow beating and saddling small businesses with mandates would go a long way. People are not defaulting because they took out option ARMs anymore, it's because the economy is in a nosedive and this Administration is doing nothing to stop it.

In addition, these programs are cumbersome and confusing to all parties---borrowers, servicers, lenders, etc---and they seem to reward the wrong behavior, such as borrowers purposefully falling behind on their mortgages so they qualify. To me this is simply a symptom of the government inserting itself into the situation. Unfortunately the housing sector is basically being run by the government at the moment. The vast majority of mortgages in this country are in some way, shape or form, being backed by Uncle Sam. Until we reverse this trend, and get our economy going again, we are going to keep running into these problems.

I'm looking forward to the testimony of the witnesses.

Treasury Assistant Secretary for Financial Stability Herbert Allison
Testimony before the House Financial Services Committee
"The Private Sector and Government Response to the Mortgage Foreclosure Crisis"
December 8, 2009

Chairman Frank, Ranking Member Bachus, and members of the House Financial Services Committee, thank you for the opportunity to testify today about the Administration's comprehensive initiatives to stabilize the U.S. housing market and support homeowners.

The Administration has made strong progress in ramping up the Making Home Affordable programs. Over 680,000 borrowers have entered into trial modifications and are already achieving significant savings. For the program to succeed in the longer run, however, we recognize that we face several key challenges: reaching more borrowers who are eligible for the program, but who often don't know how to get help or are not starting trial modifications even when approved; helping more borrowers in trial modifications convert to permanent modifications so sustainable help can be offered; and continuing to improve transparency and enhance the borrower experience, so the public and homeowners can be confident the program is assisting eligible homeowners as intended. We can all do better in ensuring that the Making Home Affordable programs are a success.

On February 18, the Administration announced the Homeowner Affordability and Stability Plan – a broad set of programs designed to stabilize the U.S. housing market and keep millions of homeowners in their homes.

The Administration has taken broad action to stabilize the housing market, including providing support for mortgage affordability across the market. Continued support for Fannie Mae and Freddie Mac and the Treasury's Mortgage Backed Securities (MBS) purchase program, along with MBS purchases by the Fed have helped to keep interest rates at historic lows. Over 3 million Americans have taken advantage of these lower rates in 2009 to save money through refinancing. For example, on a median house purchase of $200,000, a one-percent reduction in interest rates, on a purchase or refinance, saves the family over $120 per month for the thirty-year life of the loan -- real help for America's homeowners. We are working to provide increased access to financing for state and local housing finance agencies, which provide sustainable homeownership and rental resources in all 50 states, for working Americans. In addition, the first-time homebuyer tax credit has helped hundreds of thousands of responsible Americans purchase a home. The American Recovery and Reinvestment Act also supported the Low Income Housing Tax Credit/Tax Credit market by creating an innovative Treasury Tax Credit Exchange Program (TCEP) and providing gap financing through the HUD Tax Credit Assistance Program (TCAP), in combination these programs are estimated to provide over $5 billion in support for affordable rental housing. The Recovery Act also provided $2 billion in support for the Neighborhood Stabilization Program, which is designed to rebuild value in areas hardest hit by foreclosures, in addition to $4 billion provided for the program in the Housing and Economic Recovery Act.

There are clear signs that our efforts are having a substantial impact. While there are still risks, we are seeing signs of stabilization in housing, as housing inventories continue to fall. House prices measured on a year-over-year basis are declining less rapidly, with some house price measures posting increases in recent months. Conventional 30 year fixed rate mortgages remain near historic lows, and more than three million GSE borrowers refinanced in 2009 into loans with lower interest rates, and have saved $150, on average per month.

The Home Affordable Modification Program (HAMP), which provides eligible homeowners the opportunity to significantly reduce their monthly mortgage payment, is a key part of this effort, designed to help millions of homeowners remain in their homes and prevent avoidable foreclosures. As of November 17, over 680,000 borrowers are in active modifications, saving an average of over $550 a month on their monthly mortgage payments. Servicers report that over 900,000 borrowers have received offers to begin trial modifications.

HAMP is on track to provide a second chance for up to 3 to 4 million borrowers by the end of 2012, averaging over 20,000 trial modifications started per week. As with any new program of this size and complexity, HAMP faces a number of challenges, including converting trial modifications to permanent modifications and helping Americans stay in their homes in an environment of elevated unemployment. The Administration is working to address these challenges and to maximize the effectiveness of the HAMP program going forward.

Our most immediate and critical challenge is converting trial modifications to permanent modifications. All mortgage modifications begin with a trial phase to allow borrowers to submit the necessary documentation and determine whether the modified monthly payment is sustainable for them. As the first round of modifications reaches the deadline to convert, Treasury is implementing an aggressive conversion campaign to address the challenges that borrowers confront in receiving permanent modifications.

Currently servicers report that about 375,000 trial modifications will have finished a three month trial period with timely payments before 12/31/2009. Informal survey data from servicers indicate receipt of complete documents in about 30% of active trial modifications – these modifications where borrowers have returned all required documents need to be decisioned by servicers as quickly as possible. For other borrowers, servicers report that the large majority are current on their payments, but have some of the required documentation missing from applications. Housing counselors and homeowners report that servicers are losing documents, while servicers report that homeowners are not providing documents despite repeated outreach. Thousands of borrowers have successfully converted trial modifications to permanent modifications – but this is a low number compared to the total number of trial modifications. Although we know that not every borrower will qualify for a permanent modification, we are disappointed in the permanent modification results thus far. We all need to do better at converting borrowers to permanent modifications. For that reason, the program's central focus at this point is converting borrowers into permanent modifications where they qualify. As part of our conversion drive, the Administration remains committed to transparency – and to that end we will provide servicer specific data on permanent modifications this Thursday in our monthly public report.

Last week, Treasury kicked off a "Mortgage Modification Conversion Drive" including a number of aggressive actions to increase the number of permanent modifications. Those actions include the following:

- Streamlining the application process for servicers and borrowers. Standardized paperwork makes it easier for borrowers to request a modification and increases the efficiency with which servicers evaluate those requests.

- Publishing servicer-specific conversion rates in the next public report.

- Punitive measures for servicers. Those that do not meet their obligations under the program contracts will be subject to consequences which may include corrective action, withholding or clawbacks of servicer incentive payments and other remedies.

- Increased communication with servicers. On December 7, we held an in-person meeting with servicers in Washington, DC to focus on converting borrowers to permanent modifications where they qualify.

- Requiring each servicer to report to us twice a day on conversion progress.

- The implementation of "SWAT Teams," made up of Treasury staff, as well as staff from Fannie Mae, who have been sent to the largest servicer shops this week to ensure that servicers are processing conversions in a thorough, timely and efficient manner.

- New tools for borrowers have been added to our website, www.makinghomeaffordable.gov to help borrowers submit their documents.

- Engaging key state and local organizations and housing counseling groups in an outreach campaign to help borrowers submit the documents required to convert to permanent modifications.

Mortgage Modification Conversion Drive

We are focused on reaching homeowners who are eligible for permanent mortgage modifications. The mortgage modification conversion drive includes a number of elements mentioned above, but are outlined in more detail below.

- Servicer Accountability. In addition to the Administration's ongoing efforts to hold servicers accountable for their commitment to the program and responsibility to borrowers, the following measures will be implemented during the conversion campaign:

    - We required the seven largest servicers (representing nearly 90% of all active Trial Period Plans) to submit conversion plans demonstrating their ability to reach a decision on each loan for which they have documentation and to communicate either a modification agreement or denial letter to those borrowers on or before December 31, 2009. We also required servicers to submit their strategy for obtaining documentation from borrowers who are currently making payments under a trial period plan but have not submitted all of their documentation. Treasury reviewed the adequacy of these plans and required servicers to correct any deficiencies.

    - To emphasize for servicers the importance that Treasury places on the Conversion Campaign and to assist servicers in successfully transitioning the maximum number of eligible borrowers to permanent modifications, teams comprised of Treasury and Fannie Mae account liaisons are being assigned to the offices of the top seven servicers. The imbedded teams will monitor daily progress against the servicer's plan and help resolve policy issues that are impeding the conversion process. Daily progress will be aggregated at the end of each business day and reported to the Administration.

- The December MHA Servicer Performance Report will include the number of active trial period modifications that will convert by the end of the year if all borrower documents are received, sorted by servicer and date, and support a permanent modification.
- Servicers are being required to report to the Administration the status of all trial modifications in their portfolio in order to provide a more comprehensive understanding of the program's overall performance and effectiveness.

- Web tools for borrowers. Because the document submission process can be a challenge for many borrowers, the Administration has created new resources on www.MakingHomeAffordable.gov to simplify and streamline this step. A new section of the web site includes comprehensive information about how the trial phase works and what borrower responsibilities are to convert to a permanent modification. Other features include:
  - A new instructional video which provides step by step instructions for borrowers;
  - Links to all of the required documents and an income verification checklist to help borrowers request a modification in four easy steps;
  - A conversion guide for borrowers who are in the trial phase;
  - New web banners and tools for outreach partners to drive more borrowers to the site and Homeowner's HOPE™ Hotline (888-995-HOPE);
  - An outreach toolkit for housing counselors, state, local and community leaders to use in their direct outreach to constituents.
  - Contact information for the U.S. Department of Housing and Urban Development to report suspected housing discrimination.

- Engagement of state, local and community stakeholders. Through the conversion drive, the Administration is engaging all levels of government - state, local and county to both increase awareness of the program and expand the resources available to borrowers as they navigate the modification process.
  - HUD is engaging staff in its 81 field offices to distribute outreach tools. HUD will also encourage its 2700 HUD-Approved Counseling Organizations to distribute outreach information to participating borrowers to ensure that they have the tools to serve as trusted resources
  - By engaging the National Governors Association (NGA), National League of Cities (NLC) and National Association of Counties (NACo), the Administration is connecting with the thousands of state, local, and county offices on the frontlines in large and small communities across the country that are hardest hit by the foreclosure crisis. These offices now have the tools to increase awareness of the program, connect with and educate borrowers and grassroots organizations on how to request a modification and take the additional steps to ensure they are converted to permanent status; and serve as an additional trusted resource for borrowers who are facing challenges with the program.

- In partnering with the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR), state regulators now have enhanced tools to assist borrowers who are facing challenges in converting to permanent modifications. Regulators are now able to work directly with our escalation and compliance teams to ensure that HAMP guidelines are consistently applied.

Operations and Compliance

Compliance

Freddie Mac, Treasury's compliance agent for HAMP, has a robust compliance program in place for HAMP. Freddie Mac began reviewing servicers in July. Recognizing that many of the servicers' processes are newly developed and most modifications are still in trial periods, these reviews have focused on the servicers' implementation activities, looking to identify process improvements. As loans move into permanent modification status and as servicers' processes mature, Freddie Mac's reviews will focus more on risk-based activities and compliance trend issues.

Freddie Mac also began a "second look" review process, where Freddie Mac is reviewing a sample of delinquent loans to ensure that borrowers have been solicited and properly evaluated for HAMP. This "second look" process began in August, and is designed to minimize the likelihood that borrower applications are overlooked or that applicants are inadvertently denied a modification.

Treasury has a compliance committee for HAMP to review and understand servicers' compliance results and determine appropriate remedies. The compliance committee's actions range from requiring improperly denied loans to be re-assessed and the borrower solicited, to operational enhancements, additional servicer oversight or monetary actions. Monetary remedies may include withholding or reducing incentive payments to servicers, or requiring repayments of prior payments made to servicers with respect to affected loans. In addition, underperforming or non-performing servicers may become subject to additional, stricter compliance reviews and monitoring.

Escalation Enhancements

Treasury has made a number of improvements to its escalation process. We have worked with Fannie Mae to set up an escalation call center so that borrowers may seek immediate assistance in completing a modification request, or to report suspected misapplication of HAMP program rules by a servicer. The staff at this center have had training specific to the HAMP program so that they will be able to work with servicers to resolve borrower issues, and to report non-compliance through the appropriate channels. The staff are to review file documentation, review decisions, and connect with servicers to reevaluate HAMP applications. In addition, the escalation team is able to refer cases to our compliance team and/or Treasury to report program violations. Fannie Mae has created a hotline for counselors and government officials who are working on behalf of borrowers and have specific HAMP concerns. Treasury also collects data from the call center to monitor case response times, common problems, and help Treasury monitor the program's effectiveness.

Servicer Metrics & Data

On August 4, we began publicly reporting servicer-specific results on a monthly basis. These reports provide a transparent and public accounting of individual servicer performance by detailing the number of trial modification offers extended and the number of trial modifications underway. As more detailed data is collected from servicers and validated through Treasury's data processing systems, Treasury will release reports with greater detail on servicer performance. The October report contained trial modification data by state. The November report, set to be released on December 10th, will contain permanent modifications by servicer. Beginning in January, the reports will include operational metrics to measure the performance of each servicer in categories such as borrower wait time in response to inquiries and response times for completed applications.

Home Affordable Modification Program Design and Goals

HAMP Guiding Principles

HAMP is built around three core concepts, designed to help the large segment of at-risk homeowners where foreclosure is both avoidable and where the homeowner wants to stay in the home.

First, the program focuses on affordability, in an effort to ensure that borrowers who hope to remain in their homes will be able to afford the modified mortgage payment structure. Every modification under the program must lower the borrower's monthly mortgage payment to 31percent of the borrower's monthly gross income. The borrowers' modified monthly payment of 31 percent debt to income (DTI) will remain in place for five years, provided the borrower remains current. We believe HAMP creates newly modified affordable loans that homeowners can both afford and understand.

Second, HAMP's pay-for-success structure aligns the interests of servicers, investors and borrowers in ways that encourage loan modifications that will be both affordable for borrowers over the long term and cost-effective for taxpayers.

HAMP offers "pay for success" incentives to servicers, investors and borrowers for successful modifications. Servicers receive an up-front payment of $1,000 for each successful modification after completion of the trial period, and "pay for success" fees of up to $1,000 per year for three years, provided the borrower remains current. Homeowners may earn up to $1,000 towards principal reduction each year for five years if they remain current. HAMP also matches reductions in monthly payments dollar-for-dollar with the lender/investor from 38 percent to 31 percent DTI. This requires the lender/investor to take the first loss in reducing the borrower payment down to a 38 percent DTI, requiring lenders/investors to share in the burden of achieving affordability. To encourage the modification of current loans expected to default, HAMP provides additional incentives to servicers and lenders/investors after current loans are modified.

Third, participating servicers are required to evaluate every eligible loan using a standard net present value (NPV) test. If the test is positive, the servicer must modify the loan. Under HAMP's loan modification guidelines, mortgage servicers are prevented from "cherry-picking" which loans to modify in a manner that might deny assistance to borrowers at greatest risk of foreclosure.

HAMP Goals and Eligible Population

The Administration expects that HAMP can help millions of at risk homeowners remain in their homes, and we are progressing toward our goal of providing assistance to as many as 3-4 million borrowers through the end of 2012.

Today, many borrowers are facing foreclosure or in some stage of the foreclosure process. These homeowners are struggling for a number of reasons, many of them outside the control of the borrower:

- Some were put in unsustainable loans;
- Many have seen their incomes decline;
- And some just bought too much home in the hopes of being able to refinance or sell after further appreciation.

HAMP is intended to help an important segment of these borrowers who are currently at-risk of foreclosure or who will be at risk prior to the end of 2012. The program is targeted to help homeowners who:

- Occupy their home as their primary residence,
- Have a loan balance less than $729,750,
- Took out their mortgage prior to Jan. 1, 2009,
- Have a mortgage payment that is greater than 31% of their gross monthly income, and
- Can afford to make a reasonable payment on a modified mortgage.

Among this target population, we also expect that there will unfortunately still be some borrowers who will not respond to outreach efforts or who will not act on trial modification offers when extended, though every effort is planned to reach out to this population.

Based on a recent survey of servicers, we estimate that as of the beginning of November there were fewer than 1.5 million homeowners who were both 60+ days delinquent and likely to meet the HAMP requirements. This puts the approximately 650,000 borrowers who had begun trial modifications as of the beginning of November in a more complete context. As we have continually stressed, while no one wants to see foreclosures, not all delinquent borrowers will qualify for HAMP modifications.

Borrowers who are in a trial modification, or have moved to permanent are seeing significant benefits:

- Borrowers have had, on average their payments reduced by over $550 per month, a reduction of roughly 35 percent from their prior payment.
- Over 230,000 adjustable rate mortgages, and nearly 450,000 fixed rate mortgages have been modified, on a trial basis, to sustainable levels.

For the millions of homeowners who are eligible for HAMP, the program provides a critical opportunity to stay in their homes. It is providing peace of mind to families who could not stay current on their

mortgages or who only recently have fallen behind on payments. It is helping to stabilize home prices for all American homeowners and, in doing so, aiding the recovery of the U.S. economy. However, it will not reach those outside of the eligibility criteria and was not designed to help every struggling homeowner. Even with HAMP expected to help millions of homeowners remain in their homes, we unfortunately should still expect millions of foreclosures for the reasons mentioned above, as President Obama noted when he launched the program in February.

Policy Developments and Challenges:

As with any new program with the size and complexity of HAMP, the program faces a number of challenges, which the Administration is addressing aggressively.

Home Affordable Foreclosure Alternatives

We recognize that any modification program seeking to avoid preventable foreclosures has limits, HAMP included. HAMP does not, nor was it ever intended to address every delinquent loan. In these instances, the borrower may benefit from an alternative that helps the borrower transition to more affordable housing and avoid the substantial costs of a foreclosure. For instance, some borrowers do not have sufficient resources to support a HAMP modification at 31% of their income. For borrowers such as these, the Foreclosure Alternatives Program can help prevent costly foreclosures and minimize the damage that foreclosures impose on borrowers, financial institutions and communities. For those borrowers who meet the eligibility criteria for HAMP but do not successfully complete a Trial Period Plan, or default on a HAMP modification, on November 30 we published guidelines for the Foreclosure Alternatives Program, which provides incentives for short sales and deeds-in lieu of foreclosure where borrowers are unable or unwilling to complete the HAMP modification process. Borrowers are eligible for relocation assistance of $1,500 and servicers will receive a $1,000 incentive for completing a short sale or deed-in-lieu. In addition, investors will be paid up to $1,000 for allowing short sale proceeds to be distributed to subordinate lien holders.

Foreclosure proceedings

We have heard from borrowers that more clarification is needed about the rules regarding foreclosure when borrowers apply for a trial modification and during the trial period. Borrowers have expressed particular concerns about notices regarding foreclosure actions that were begun before they were considered for HAMP. Under the contract that all participating servicers have signed, any pending foreclosure sale must be suspended and no new foreclosure proceedings may be initiated during the trial period. Foreclosure proceedings may not be initiated or restarted until the borrower has failed the trial period and the borrower has been considered and found ineligible for other available foreclosure prevention options. Servicers who violate any of these rules are considered non-compliant. Counselors and borrowers should report violations through the escalation channels. Freddie Mac receives trend information and can view all complaints recorded by Fannie Mae. This complaint information is then factored into Freddie Mac's risk analysis to determine frequency and type of compliance activities to be performed at servicers. If a pattern or significant increase in complaints occur, Freddie Mac will, and has, performed targeted reviews.

In addition, Treasury has convened an integrated working group including servicers, foreclosure attorneys and housing advocacy organizations to review and develop improvements to our existing foreclosure suspension rules, to ensure that no borrower being evaluated for HAMP is subject to foreclosure.

Improving Transparency

Every borrower is entitled to a clear explanation if they are determined to be ineligible for a HAMP modification. Treasury has established denial codes that require servicers to report the reason for modification denials in writing to Treasury. Servicers are now required to use those denial codes as a uniform basis for sending letters to borrowers who were evaluated for HAMP but denied a modification. In those letters, borrowers will be provided with a phone number to contact their servicer as well as the HOPE hotline, which has counselors who are trained to work with borrowers to help them understand reasons they may have been denied a modification and explain other modification or foreclosure prevention options that may be available to them.

Transparency of the Net Present Value (NPV) model – a key component of the eligibility test – is also important. We are increasing public access to the NPV white paper, which explains the methodology used in the NPV model. We are also working to increase transparency of the NPV model, including new tools that counselors can use to assist distressed homeowners applying for modifications. To ensure accuracy and reliability, Freddie Mac, acting as our compliance agent, conducts periodic audits of servicer's implementation of the model. If servicers' models do not meet Treasury's NPV specifications, Freddie Mac will require the servicers to no longer use their own implementation of the model and revert back the NPV application available through the MHA Servicer Portal.

Unemployment

HAMP has been designed to allow unemployed borrowers to participate in the program. Unemployed borrowers who have 9 months or more of unemployment insurance (UI) remaining are eligible to include UI in their income for consideration in the NPV calculation. Unemployed borrowers are also allowed to include other sources of passive income like rental income as well as income from an employed spouse, which will qualify some borrowers for a modification. We recognize, however, that some unemployed borrowers will have trouble qualifying for a modification because their income is insufficient to pass the NPV test.

Treasury is aware of a number of policy proposals that have been advocated to further assist unemployed borrowers, including the model provided by Pennsylvania's Homeowners' Emergency Mortgage Assistance Program (HEMAP), the Foreclosure and Unemployment Relief Plan proposed by academics at the University of Wisconsin, proposals put forward by economists from the Federal Reserve Bank of Boston, and other ideas. While our key focus is on helping as many borrowers as quickly as possible under the current program, Treasury recognizes that unemployment presents unique challenges and is still actively reviewing various ideas and suggestions in order to improve implementation and effectiveness of the program in this area.

Conclusion

In nine months, the Administration has accomplished a great deal and helped homeowners across the country. But we recognize the continued commitment needed to help American families during this crisis and will aggressively continue to build on our progress to date.

Sustained recovery of our housing market, and the mitigation of foreclosures, is critical to lasting financial stability and promoting a broad economic recovery.

We look forward to continuing to work with you to help keep Americans in their homes, restore stability to the U.S. housing market and ensure a sustained economic recovery.

Testimony of:

Laurie S. Goodman

Senior Managing Director

Amherst Securities

Before the House Financial Services Committee

Hearing: The Private Sector and Government Response to the Mortgage Foreclosure Crisis

December 8, 2009

I am honored to testify today. My name is Laurie Goodman and I am a Senior Managing Director at Amherst Securities, a leading broker/dealer specializing in the trading of residential mortgage backed securities. I am in charge of the strategy and business development efforts for the firm. As part of our efforts to keep both ourselves and our customers abreast of trends in the residential mortgage backed securities market, we do an extensive amount of data intensive research. I would like to share some of our results with you today.

As a result of my testimony, I hope to leave you with 2 points:

- The housing market is fundamentally in very bad shape. The single largest problem is negative equity.
- The current modification program does not address negative equity, and is therefore destined to fail. It must be amended to explicitly address this problem. And there is no single solution; it is a combination of policy measures. Clearly, the arsenal of solutions must include principal reduction and must explicitly address the loss allocation between first lien investors and second lien investors.

In order to place today's topic into context, it is important to take a step back and take an objective look at the housing market. The Mortgage Bankers Association Delinquency Survey for Q3 shows that 14.1% of borrowers are not making their mortgage payments. This means 7.9 million homeowners did not pay their mortgage in Q3. This is a dramatic increase from several years ago for a number of reasons: (1) borrowers are transitioning into delinquency at a rapid rate, (2) cure rates are extremely low, and (3) the time from when a borrower first goes delinquent and when the home is liquidated has lengthened dramatically.

Given the current trajectory, we estimate that approximately 7 million of these 7.9 million homeowners will be forced into vacating their properties. And this estimate of 7 million units includes only the borrowers that have already stopped making their payments. It does not include the 250 thousand new borrowers per month who stop making their payments. What about modifications? Aren't they supposed to help relieve this? Yes, but they can't help considerably, as their success rate has been low.

The real problem is that default transition rates are high and cure rates are low because the borrower has negative equity in their home. Most borrowers do not default because of negative equity alone. Generally, a borrower experiences a change in financial circumstances, misses a payment on their mortgage and then re-evaluates their financial circumstances. If the home has substantial negative equity, they will choose to walk.

A few numbers will help illustrate this point. At Amherst we did a study looking at all prime borrowers who were 30 days delinquent on their mortgage 6 months ago. We sorted these mortgages by the amount of equity the borrower had in their home. We then came back 6 months later, and looked at whether the borrower was at least 60 days delinquent. For prime borrowers with 20% equity, only 38%

had become 60+ days delinquent. For prime borrowers with substantial negative equity (a combined Loan-to-value ratio of 141-150) 75% had become 60+ days delinquent.

There is a substantial group of people who have argued that the primary problem is not negative equity, it is unemployment. This argument is not supported by the evidence. First, the increase in delinquencies for subprime, Alt-A and pay option ARM mortgages began to accelerate in Q2, 2007. By contrast, we did not begin to see large increases in unemployment until Q3, 2008.

Further evidence of the importance of negative equity comes from another study we recently published entitled "Negative Equity Trumps Unemployment in Predicting Defaults." The results were very striking:

- The combined loan-to-value ratio or CLTV plays a critical role. For Prime and Alt-A loans in low unemployment areas the default frequency was at least 4 times greater for borrowers underwater by 20% than it was for borrowers with at least a 20% equity position.
- If a borrower has positive equity, unemployment plays a negligible role. We found that all borrowers with positive equity performed similarly no matter the local level of unemployment.
- If a borrower has substantial negative equity (mark-to-market CLTV>120), unemployment plays a role, but less than CLTV. If the borrower has a CLTV greater than 120, the default frequency was 50% to100% higher in a high unemployment area versus a low unemployment area.

The evidence is irrefutable. Negative equity is the most important predictor of default. When the borrower has negative equity, unemployment acts as one of many possible catalysts, increasing the probability of default.

HAMP modifications are, as you are aware, primarily a payment reduction plan. HAMP aims to lower the payment on the first mortgage plus taxes and insurance to 31% of a borrower's income.

HAMP has three fatal flaws. First the agent retained to make the modification was a mortgage servicer rather than an originator. This created a significant amount of ramp time as many servicers were not equipped to handle the many functions necessary to underwrite a modification. Second, HAMP only considers the first mortgage payment, taxes and insurance. It does not consider the borrower's total financial circumstances, including the second mortgage and other debt. Third, and most importantly, the program does not emphasize the re-equification of the borrower.

What makes us think that principal reduction would be a more effective modification tool than payment reductions? A few pieces of evidence point to this. First, the OCC/OTS reports that in Q2, 30.5% of mortgage loans in bank portfolios received a principal reduction as part of the modification. The corresponding number was zero for Fannie, Freddie, Government guaranteed and private mortgages. Thus, when the same party owns the first mortgage, the second mortgage, and the servicing, they look to maximize the net present value of the loan and often choose to do principal reduction. It is important to note that modifications on mortgage loans in bank portfolios have a much lower re-default rate than other types of loans.

What can/should be done? Here are some imperatives.

First, there is no one size fits all approach to modifications. There must be an explicit recognition that, in many cases, HAMP modifications as currently designed are not working. We believe that beating up on servicers to "do more" poorly designed modifications won't solve the problem. The program as implemented is addressing the wrong issue.

Second, moving principal reduction higher in the HAMP modification waterfall would be the most natural way to raise the success of the modification program. Would investors support this type of program? Absolutely! While a foreclosure is devastating to a borrower, it is also devastating to an investor—the recovery rate on a subprime loan is less than 30 cents on the dollar. It is approximately 50 cents on the dollar for a prime loan with a 200-400k loan size. The interests of the first lien investor and the borrower are totally aligned. It would be completely reasonable to further incentivize the investor to reduce loan balances through a government sponsored plan to liquefy properly de-risked loans. These would be loans in which the borrowers have performed as expected for some reasonable period of time after modification.

Third, any principal reduction program requires the Administration to address the second lien problem head on. The solution is clear-- the banks that own the second liens will have to write them down. The treasury may choose to pay an "extinguishment fee"; it may make sense to allow the banks to take the losses over time. But, for the sake of giving homeowners the best chance to stay in their home, the second lien will have to be extinguished. It should be noted that second liens have thus far, under HAMP, been treated with kid gloves. While the first lien modification program is fully operational, to the best of my knowledge the second lien program has not yet been implemented. Thus borrowers are paying the modified first lien amount and the full second lien amount, making the second lien, in effect, senior to the first lien. And even when the second lien program is implemented, it will merely make the second lien pari passu to the first lien.

Fourth, we endorse the revamped Hope for Homeowners Program, in which the borrower is refinanced into a government mortgage. This is a program that is apt to have far lower re-default rates than the HAMP modification efforts. The first version of this program was so cumbersome as to be non-operational. The recent revamp of this program addresses some of the issues. Two big issues that have not been addressed are: (1) the second lien issue and (2) misalignment of interests. We believe that were an institution to own the first mortgage, the second mortgage and the servicing, the institution may find this program to be a viable outlet, as the focus is on maximizing the NPV of all investments. We do not believe that this program will prove to be a viable outlet for loans backed by private label securitizations, as all interests are not aligned. The benefits of this program accrue mostly to the first lien investor, while the costs of this program fall on both the party that must fully document the modification (the servicer) but also the party that must write down the second lien (often the servicer).

Fifth, we need more transparency on the data. Releasing data on the number of completed modifications versus the number of modifications that were started in May, June, July etc would be a

helpful first step. Releasing data on the stage at which the modification attempt failed is critical. Data on the characteristics of permanent modifications and the performance of these permanent HAMP modifications is also very important. The only information we have on completed modifications comes from the Congressional Oversight Panel's October report on the first 1,700 completed modifications. The Panel found that the average payment was reduced by 34% and negative equity was actually increased from an average LTV of 134.1 to 136.6. That is, principal and interest advances were capitalized into the new balance, and there was relatively little principal forbearance. And principal forbearance is not very effective—the borrower still technically owes the money, so he has not been re-equified.

We do acknowledge that a poorly structured principal reduction plan could trigger additional strategic defaults. The proper plan will create significant frictions that would make a strategic default unattractive to borrowers who otherwise could afford to pay their mortgage. There is no single option here—shared appreciation features, requiring all reduced principal mortgages to be made with recourse, introducing an impact on credit scores and limiting future access to credit or ability to borrow against the property are among the ideas that must be considered.

We are concerned that if policies continue to kick the can down the road—working with a modification problem that does not address negative equity—delinquencies will continue to spiral with no end in sight.

My testimony has been focused exclusively on mortgage modifications. There are other measures that must also be taken if the capital markets are to function efficiently again. Amherst looks forward to working with this committee on the modification issue, as well as the broader set of capital markets issues.

Thank you very much for allowing me to testify today, it has been an honor.

Testimony of Julia Gordon, Center for Responsible Lending
Before the U.S. House of Representatives Committee on Financial Services

"The Private Sector and Government Response to the Mortgage Foreclosure Crisis"

December 8, 2009

Good morning Chairman Frank, Ranking Member Bachus, and members of the committee, and thank you for the invitation to participate today. We are now facing historic levels of homes lost through foreclosures. Not every individual foreclosure can or should be stopped, but there is an urgent need to stop the epidemic by closing the growing chasm between prevention and losses. Without stronger policy intervention, not only will millions of families lose their homes unnecessarily, but massive foreclosures will continue to destroy communities, drag down the housing market, and keep a full economic recovery out of reach.

I serve as Senior Policy Counsel at the Center for Responsible Lending (CRL), a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, a nonprofit community development financial institution that consists of a credit union and a non-profit loan fund. For close to thirty years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through financing home loans to low-income and minority families who otherwise might not have been able to get affordable home loans. Self-Help's lending record includes a secondary market program that encourages other lenders to make sustainable loans to borrowers with weak credit. In total, Self-Help has provided over $5.6 billion of financing to 62,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across America.

The downturns in the housing market and economy are impacting Self-Help as well as other lenders. As a result, we have had to step up our loss mitigation activity significantly. In the process, Self-Help is grappling with many of the same issues encountered by other lenders, including servicer issues, increasing borrower outreach, and developing a loan modification program that works for people who are facing many economic challenges. Our testimony today is informed by this experience.

Reckless and abusive lending practices created a nationwide foreclosure crisis that has had catastrophic consequences for families, communities—especially communities of color—and the overall economy. Historically, the housing sector has led the way out of economic downturns.[1] Yet with one in seven homeowners behind on their mortgage or in foreclosure[2] and one in four mortgages underwater,[3] continued weakness in the housing sector will likely slow or derail economic recovery and hamper efforts to create jobs and reduce unemployment.

The housing crisis is sufficiently broad and deep that there is no "silver bullet" strategy to stop the downward spiral of foreclosure-ravaged neighborhoods. Moreover, the problem

has evolved from the subprime loan failures of 2007 to a broader problem among all loans exacerbated by steep housing price declines and widespread unemployment. Because the problem has spread and become even more complex over time, the necessity of addressing it through multiple solutions had become even more necessary and urgent.

We are glad that the Administration has taken this problem seriously and has created a significant program to address it. We now must ensure that this program reaches its potential and that the government has a sufficiently broad array of tools at its disposal to target different types of loans and homeowner situations. For each aspect of the foreclosure prevention program, we should consider both how it theoretically addresses each problem and also whether the program's goals are achievable given the resources on the ground. For example, while the current HAMP program has the theoretical potential to help a very significant number of homeowners, it has not reached its potential so far because the servicing industry is either unable or unwilling to do what it has been asked to do.

In this testimony, we offer a number of recommendations and ideas for improving the HAMP program and for making its goals achievable. Many of these recommendations address well-documented problems that we believe have readily achievable solutions, so we urge immediate adoption and implementation of these recommendations. Some of the other ideas put forward here are in areas where it is clear that additional action is required, but the potential response requires further testing and development.

In our view, the following efforts are likely to have the highest impact in preventing foreclosures and protecting homeowners:

- Stop foreclosures while servicers evaluate eligibility for loan modifications or other non-foreclosure options.
- Make the "net present value" (NPV) model for qualifying homeowners transparent and available to the public.
- Share data with the public to ensure that all stakeholders have the opportunity to propose evidence-based solutions to the problem.
- Ensure that homeowners have adequate equity in their homes to continue with successful homeownership by reducing principal balances on troubled loans.
- Create a program to assist homeowners who have lost their jobs and do not have nine months of guaranteed unemployment income.
- Transfer servicing to entities that don't have conflicts and automatically convert trial modifications into permanent modifications.
- Pass legislation mandating loss mitigation prior to foreclosure.

In addition, Congressional or Treasury action in several other areas would provide significant benefit in mitigating the crisis:

- Provide an independent appeals process easily accessible by homeowners.
- Prohibit servicers from requiring homeowners to waive legal rights when receiving a modification.

- Permit homeowners who experience additional adverse life events to be eligible for additional HAMP modifications.
- Clarify that homeowners in bankruptcy are eligible for the HAMP program.
- Ensure that homeowners receiving mortgage debt forgiveness or modifications do not find their new financial security undermined with a burdensome tax bill.
- Create the Consumer Financial Protection Agency, which can establish and monitor common-sense rules to ensure this type of crisis never happens again.
- Prohibit predatory lending in the future, particularly unsustainable loans, yield spread premiums and prepayment penalties.

I. Background

A. Foreclosures continue to soar and the mortgage market continues to suffer.

According to estimates from the Mortgage Bankers Association, since 2007, nearly six million foreclosures have been initiated.[4] Right now, approximately six and a half million more homes are at risk, with the homeowners either more than 30 days behind on their mortgage or with the home already in the foreclosure process. Continued high unemployment as well as the new wave of defaults expected due to option ARM and other Alt-A mortgages will add millions more to this total. Without significantly more intervention to stop foreclosures, by the time this crisis abates, as many as 13 million families will have lost their homes.[5]

In addition, the spillover costs of the foreclosure crisis are massive. Beyond the homes that are at risk of foreclosure themselves, tens of millions of other homes – households where the owners have paid their mortgages on time every month – are suffering a decrease in their property values that amounts to hundreds of billions of dollars in lost wealth just because they are located close to a property in foreclosure – aside from the overall loss in property value due to the overall housing price declines.[6] These losses, in turn, cost states and localities enormous sums of money in lost tax revenue and increased costs for fire, police, and other services. As property values decline further, the cycle of reduced demand and reduced mortgage origination continues to spiral downward.

B. Toxic loan products are at the heart of the mortgage meltdown.

1. The housing crisis was precipitated by risky loans, not risky borrowers.

Since the problems in the subprime market became evident in early 2007, many in the mortgage industry evaded responsibility and fended off government efforts to intervene by blaming the borrowers themselves, saying that lower-income borrowers were not ready for homeownership or not able to afford it.[7] Yet empirical research shows that the leading cause of the problem was the characteristics of the market and mortgage products sold, rather than the characteristics of the borrowers who received those products.

More specifically, research has shown that the elevated risk of foreclosure was an inherent feature of the defective nonprime and exotic loan products that produced this crisis. Loan originators—particularly mortgage brokers—frequently specialized in steering customers to higher-rate loans than those for which they qualified and loans loaded with risky features. In late 2007, the Wall Street Journal reported on a study that found 61% of subprime loans originated in 2006 "went to people with credit scores high enough to often qualify for conventional [i.e., prime] loans with far better terms."[8] Even applicants who did not qualify for prime loans could have received sustainable, thirty-year, fixed-rate subprime loans for—at most—half to eight tenths of a percent above the initial rate on the risky ARM loans they were given.[9] Perhaps even more troubling, originators particularly targeted minority communities for abusive and equity-stripping subprime loans, according to complaints and affidavits from former loan officers alleging that this pattern was not random but was intentional and racially discriminatory.[10]

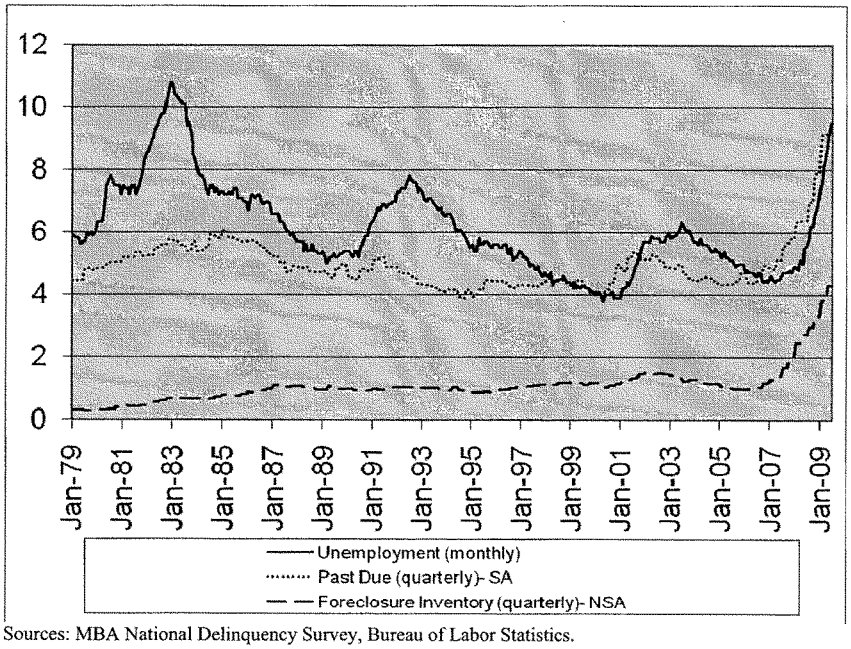
Our research has also demonstrated that common subprime loan terms such as adjustable rate mortgages with steep built-in payment increases and lengthy and expensive prepayment penalties presented an elevated risk of foreclosure *even after accounting for differences in borrowers' credit scores.* It has also shown how the risk entailed in these loans had been obscured by rapid increases in home prices that had enabled many borrowers to refinance or sell as needed. The latent risk in subprime lending has been confirmed by other researchers from the public and private sectors.[11]

A complementary 2008 study that we undertook with academic researchers from the University of North Carolina at Chapel Hill supports the conclusion that risk was inherent in the loans themselves.[12] In this study, the authors found a cumulative default rate for recent borrowers with subprime loans to be more than three times that of comparable borrowers with lower-rate loans. Furthermore, the authors were able to identify the particular features of subprime loans that led to a greater default risk. Specifically, they found that adjustable interest rates, prepayment penalties, and broker originations were all associated with higher loan defaults. In fact, when risky features were layered into the same loan, the resulting risk of default for a subprime borrower was four to five times higher than for a comparable borrower with the lower-rate fixed-rate mortgage from a retail lender.

Finally, CRL conducted a more targeted study to focus on the cost differences between loans originated by independent mortgage brokers and those originated by retail lenders. In that study, we found that for subprime borrowers, broker-originated loans were consistently far more expensive than retail-originated loans, with additional interest payments ranging from $17,000 to $43,000 per $100,000 borrowed over the scheduled life of the loan.[13] Even in the first four years of a mortgage, a typical subprime borrower who used a broker paid $5,222 more than a borrower with similar creditworthiness who received their loan directly from a lender.[14]

2. While high unemployment makes a bad situation worse, unemployment itself is not the reason for the soaring foreclosure rate.

In light of the high unemployment rates now prevailing across the country, it is useful to examine the relationship between unemployment, mortgage delinquency, and foreclosures.[15] The chart below shows that during previous periods of very high unemployment, delinquency levels did rise somewhat, but they rose far less than they've risen during the recent crisis. Even more telling, during those previous periods of high unemployment, foreclosure numbers remained essentially flat.[16]



Sources: MBA National Delinquency Survey, Bureau of Labor Statistics.

The reason that the current housing-led recession has been accompanied by unprecedented levels of delinquency and foreclosure is due to the shift in the past decade from relatively safe, fully underwritten, fixed-rate, amortizing mortgages to unsustainable, dangerous and confusing mortgage products with adjustable rates. The lack of appropriate underwriting for ability to repay has led to mortgage debt consuming far more of a family's total income, which makes it harder to survive a period of unemployment without defaulting (other debt, such as credit card debt, is also at much higher levels that have been the case historically).

Also, in past recessions, homeownership served as a buffer against income interruptions. Homeowners facing unemployment could sell their homes or tap into their home equity

to tide them over. Yet today, vast numbers of homeowners have little or no equity at all. Selling homes is difficult to impossible in many markets, and even when sales take place, the former homeowner sees no net proceeds from the sale. This problem exists because the glut of toxic mortgages first inflated the housing bubble and then led to the bursting of the bubble, followed by a self-reinforcing downward spiral of home prices.

As the nation's unemployment numbers continue to rise, some have questioned whether focusing on job creation strategies would be preferable to restructuring mortgages or reforming the way home loans are made. Certainly unemployment or underemployment is contributing significantly to the dire economic straits in which many families find themselves, impacting their ability to pay mortgages as well as other debts and living expenses. But the assertion that unemployment is the cause of the current foreclosure crisis is incorrect, and to make a difference in the foreclosure rate, we must directly address failing mortgages.

II. The government, private industry, and the nonprofit sector must all work together to stop as many foreclosures as possible and interrupt the downward cycle of housing price declines and continued economic weakness.

As goes the housing sector, so goes the economy. While we have seen some improvements in the housing market recently, a large increase in foreclosures could lead to a double-dip recession or at least to a slower recover. For this reason, it is imperative that we continue to try to stop foreclosures and restore health to the housing market, even as it becomes clear that this task is much more daunting than some may have imagined. Not only does it reflect badly on us as a society that we would permit so many people to lose their homes, but the enormous costs both to homeowners and to state and local governments will continue to drag the economy down (it is worth noting that these external costs are not accounted for by the HAMP program's net present value analysis). With no easy solution to this problem, all stakeholders must work together to come up with innovative, workable strategies that can adapt as circumstances change.

A. In our view, the following efforts are likely to have the highest impact in preventing foreclosures and protecting homeowners:

A first priority is to ensure that the federal government's programs are reaching their goals. Unfortunately, neither Treasury's Home Affordable Modification Program (HAMP) nor HUD's Hope for Homeowners (H4H) program have yet produced the hoped-for results.[17]

The HAMP program, initially projected to help three to four million borrowers, works by reducing homeowner payments to an affordable level, defined as a 31% debt-to-income ratio. After nine months of operation, approximately 650,000 homeowners are now in a trial modification, yet only a fraction of those have received a permanent loan modification.[18] What's more, early indications are that close to a quarter of these trial modifications have failed prior to the end of the three-month trial period, some failing in the first month.[19] Homeowners and their advocates report that the program is hard to

access, and the program itself still presents serious barriers to mass loan modifications.[20] The program's effectiveness has been hampered by a severe problem with servicer capacity, by a piece-by-piece rollout of complementary programs addressing second liens and short sales, and by lagging compliance, data availability, and appeals procedures.

To improve the HAMP program and extend its reach, we have outlined a number of recommendations below.

1. Foreclosures should be stopped while servicers evaluate eligibility for loan modifications or other non-foreclosure options.

Because servicers are not barred from proceeding on a parallel track toward foreclosure while a HAMP evaluation is pending, homeowners are receiving a confusing mix of communications from their lender, some of which tell the borrowers they are being considered for HAMP, but others of which warn of an impending foreclosure sale. This mixed message may well lie at the heart of several vexing problems, including the failure of borrowers to send in all their documentation, the early redefault of many trial modifications, and the difficulty servicers have reaching certain borrowers.

In addition, the continuation of the foreclosure process often means that the servicers' lawyers bill thousands of dollars in attorneys fees that the homeowners are then expected to pay. Servicers either demand these payments upfront (an apparent violation of HAMP) or add the costs into the loan balance. In either event, these costs make it harder to provide an affordable loan modification.

Finally, although HAMP guidelines prohibit the actual foreclosure sale from taking place prior to a HAMP evaluation, some sales are taking place anyway because the foreclosure proceedings are handled by outside law firms and communications between servicers and foreclosure attorneys regarding HAMP are extremely minimal.[21]

To alleviate the confusion and prevent inadvertent foreclosures, servicers should be barred from proceeding with any portion of a foreclosure action prior to concluding their determination of whether a borrower qualifies for a HAMP modification. In other words, they should not be permitted to institute an action, and if an action has already been instituted, they should not be permitted to move forward at all, in cases where they can reach the homeowner or the homeowner has already requested an evaluation. Guidelines should be established to clarify when the servicer can continue with foreclosure proceedings if the homeowner is unreachable.

2. Make the NPV model for qualifying homeowners transparent and available to the public.

A homeowner's qualification for a loan modification under HAMP is determined primarily through an analysis of the Net Present Value ("NPV") of a loan modification as compared to a foreclosure. The test measures whether the investor profits more from a loan modification or a foreclosure. The outcome of this analysis depends on inputs

including the homeowner's income, FICO score, current default status, debt-to-income ratio, and property valuation, plus factors relating to future value of the property and likely price at resale. Servicers that participate in HAMP are required to apply a specific NPV analysis model to all homeowners who are 60 days delinquent and those at imminent risk of default. Homeowners and their advocates need access to the HAMP program's NPV model so that they can determine whether servicers have actually and accurately used the program in evaluating the homeowner's qualifications for a HAMP modification. Without access to the NPV analysis, homeowners are entirely reliant on the servicer's good faith.

Treasury has recently made some modest improvement on this front by requiring servicers to provide homeowners who are denied a HAMP modification based on the NPV calculation an opportunity to verify certain inputs the servicer used in making the NPV calculations. This requirement should be strengthened to require servicers automatically to provide the NPV inputs to homeowners denied a HAMP modification, instead of requiring homeowners to make a request for the data. Servicers should also be required to provide borrowers with the numerical results of the NPV calculations, rather than the mere result that modifying their loan would pass or fail the test. Finally, servicers should be required to allow borrowers to review the property valuation used in the NPV calculation, as it is one of the inputs with the greatest effect on the results.

3. **Share data with the public to ensure that all stakeholders have the opportunity to propose evidence-based solutions to the problem.**

To its credit, the Treasury Department is collecting a broad range of data from servicers participating in the HAMP program. This data can shed great light into how the HAMP program is working: what types of borrowers are getting modifications and which are not, particularly as it relates to minority borrowers; the geography of modification activity; the types of modifications that are being provided; and the patterns of re-defaults that are occurring. However, the Treasury Department has severely limited the data it has released.

The loan-level data already being provided to the Treasury Department should be released to the public, both in report form and in the maximum possible raw disaggregated form so that independent researchers and other interested parties can analyze the data themselves. This data is crucial for those working to develop more and better tools to fight foreclosures and prevent a repeat of this crisis. Public access to this data should be comparable to public access to the data collected under the provisions of the Home Mortgage Disclosure Act (HMDA) data, although we hope that the data will be available in something much closer to real time.

Treasury has promised such a data release will take place, but so far, there are no details about what we can expect and when we can expect it. One troubling rumor is that race and ethnicity data will not be released on a servicer-by-servicer basis. Until more data is released, most analysts outside the Administration have only the limited information contained in the two-page reports that Treasury has been releasing on a monthly basis.

4. Ensure that homeowners have adequate equity in their homes to continue with successful homeownership by reducing principal balances on troubled loans.

There are two main reasons why addressing the question of equity position is so important: the incentives to homeowners to continue to perform on their loans, and the ability of the HAMP program to help people in payment option ARM and interest-only loans. Many analysts believe that principal reduction is ultimately the only way to help the housing market reach equilibrium and begin to recover.[22]

Many homeowners whose mortgages are at risk owe more on their mortgages than their homes are worth. While the overall percentage of American mortgages that are underwater is estimated to be 23%,[23] we can assume that percentage is higher for homeowners who are having trouble affording their mortgage.[24] It is also far higher in certain geographic areas, such as California, Nevada, Florida, and Arizona. This problem was caused by the extreme housing price declines triggered by risky lending, and in some cases is exacerbated by the mortgage product itself, such as in the case of payment option ARMs.

The phenomenon of underwater mortgages is one of the most troubling aspects of the entire housing market collapse, especially because of the correlation between negative equity and mortgage delinquency. Homeowners who are underwater have no cushion to absorb financial difficulties. Furthermore, in some cases, homeowners who are unlikely to move into a positive equity position have fewer incentives to stay in the home.[25] For these homeowners, even the reduction of monthly payments to an affordable level does not fully solve the problem. As a result, homeowner equity position has emerged as a key predictor of loan modification redefault, more so than unemployment or other facts.[26]

a) Ways to achieve principal reduction.

The OCC's Mortgage Metrics report indicates that even as loan modification activity ramps up, principal reduction is still relatively rare. One context in which it occurs is in portfolio loans with no second liens,[27] which suggests that banks understand the usefulness of principal reduction but that in situations where there are other obstacles (ie, securitized loans or loans with second liens), they are not willing to do what it takes to get to the same result. Some servicers also are writing down some principal for payment option ARM loans.

The only government program to aim at principal reduction is the Hope for Homeowners program. Under this program, if lenders agree to write loan balances down to 90 percent of current value, HUD will permit the refinancing of those loans through FHA, thereby moving distressed loans off the books of the original lender and attracting new refinance loans with the FHA guarantee. However, there are many obstacles to use of the program, including the need to extinguish all junior liens, high premiums, and a complex appreciation and equity sharing provision. After the initial failure of the program, HUD

sought Congressional authority to make some changes to the program aimed at making it more attractive, yet as of a couple of weeks ago, there have been no loans yet made under the revised program either.

As others on the panel will discuss, there are currently investors with available cash who are ready and willing to buy loans and write down principal aggressively. They believe the long-term value of a loan modified using principal reduction so that the homeowner continues to perform will ultimately exceed the current value of the loan. Yet it is almost impossible to get the servicer to initiate a principal reduction. A main reason for this lack of interest in principal reduction is that many banks hold in portfolio the second liens on securitized mortgages, which leaves the bank-owned servicers with a conflict of interest in deciding to reduce the principal balance. Other disincentives are that servicers derive the bulk of their income from the monthly servicing fee, which is set as a percentage of the outstanding loan principal balance in the pool; servicers may take a hit against their residual income if the loss is recognized immediately; and servicers may need to buy loans back out of the pool.

Ultimately, it is likely that the only way principal reduction is ever going to happen is if it is required as part of HAMP or a program like HAMP, and if there are financial incentives for taking the writedown. Alternatively, loans could be removed from the control of the servicers in some way. It may be useful to consider policies that will make it easier for investors to buy loans out of pools, as long as these incentives are only applicable when the investor plans to modify the loan for the current homeowner (recent accounting changes will make this option possible beginning in January 2010). We do not have a detailed proposal, but we believe it is crucial to explore all avenues.

So far, the only policy reason advanced for the Treasury's failure to incorporate a principal reduction into HAMP is the fear of moral hazard. While this fear is certainly understandable, given the relatively small numbers of homeowners strategically defaulting at present,[28] we think it is not anywhere near the problem that it has been made out to be. It should be possible to build numerous safeguards into the application process, narrowly tailoring eligibility and either phasing in the reduction over time or creating a shared equity component that would kick in upon sale of the home. If principal reduction is indeed a crucial component of stopping foreclosures, a fear of moral hazard should not stand in the way of additional experiments in this area.

Specifically, principal reductions should be achieved by two primary methods:

(1) Reduce principal balances to make option ARMs affordable.

One of the most problematic categories of loans right now is payment option ARMs (POARMs). POARMs allowed borrowers to choose among three different monthly payment levels: a fully amortizing payment, an interest-only payment, and a payment that did not even cover interest, thereby permitting the loan balance to grow larger (negatively amortize) during the period when the minimum payment is being made.

Unscrupulous lenders offered these loans to borrowers for whom they were not well suited, structured the products so that the payments substantially increase in five years or less when they hit their negative amortization cap, used excessive teaser interest rates to lure borrowers to the product, and failed to document income. POARMs are also the category of loans that are most likely to be underwater, both because of the negative amortization feature and because their origination was concentrated in high-cost areas that have experienced steep price declines. (The vast majority of POARM borrowers chose to make the minimum payment permitted, at least while they were still paying on their loan, meaning most of these loans were negatively amortizing even as housing prices declined.)

Homeowners with POARMs are in desperate need of assistance. In the second quarter of 2009, 15.2 percent of option ARMs were seriously delinquent, compared with 5.3 percent of all mortgages, and 10 percent were in the process of foreclosure, more than triple the 2.9 percent rate for all mortgages. [29] Unfortunately, because of the way these loans were structured, the current design of HAMP is not able to help many of the POARM borrowers get their payments to an affordable level. Minimum payments on these loans are so low that it is hard to restructure the loans without raising the monthly payments. What's more, the initial interest rates on these loans are quite low, so reducing the interest rate does not help as much as it does for loans with higher rates, and many POARMs already have a 40-year term, so a term extension cannot help either. The only way to help POARM borrowers in a sustainable way is to reduce principal.[30]

(2) Lift the ban on judicial modifications of mortgages on primary residences

Judicial modification of loans is available for owners of commercial real estate and yachts, as well as subprime lenders like New Century or investment banks like Lehman Bros., but is denied to families whose most important asset is the home they live in. In fact, current law makes a mortgage on a primary residence the only debt that bankruptcy courts are not permitted to modify in chapter 13 payment plans.

Permitting judges to modify mortgages on principal residences, which carries *zero cost to the U.S. taxpayer*, has been estimated to potentially help more than a million families stuck in bad loans keep their homes.[31] It would also help maintain property values for families who live near homes at risk of foreclosure. It would address the "moral hazard" objections to other modification proposals current under consideration, as the relief it provides would come at a substantial cost to the homeowner—including marring the homeowner's credit report for years to come and subjecting the homeowner's personal finances to strict court scrutiny. And it would complement the various programs that rely on voluntary loan modifications or servicer agreement to refinance for less than the full outstanding loan balance.

Proposals to lift this ban have set strict limits on how it must be done. Such proposals would require that interest rates be set at commercially reasonable, market rates; that the loan term not exceed 40 years; and that the principal balance not be reduced below the

value of the property. And if the servicer agrees to a sustainable modification, the borrower will not qualify for bankruptcy relief because they will fail the eligibility means test. As Lewis Ranieri, founder of Hyperion Equity Funds and generally considered "the father of the securitized mortgage market,"[32] has recently noted, such relief is the only way to break through the problem posed by second mortgages.[33]

5. Create a program to assist homeowners who have lost their jobs and do not have nine months of guaranteed unemployment income.

It has become clear that there is a need to create a program to assist unemployed homeowners who cannot demonstrate nine months of unemployment benefits necessary to qualify for a HAMP modification, yet would ultimately be successful long-term homeowners. There are at least two potential solutions to this problem. The first is to add a payment forbearance component to HAMP that would give unemployed homeowners a period of time where they did not need to pay their mortgage, without any additional fees or charges accruing. The forbearance will need to be long enough to account for the very high rate of unemployment, the slow economic recovery, and the fact that employment tends to recover later than other aspects of the economy – while we are not certain of the right length, it is clear that the typical 3 month or even 6 month forbearance will be inadequate for many homeowners.

Another proposal is to create a low-cost loan fund similar to a program created by the state of Pennsylvania to provide loans to unemployed homeowners to help them pay their mortgage. Pennsylvania's Homeowners Emergency Mortgage Assistance Program (HEMAP) has provided loans to over 43,000 homeowners since 1984 at a cost to the state of $236 million. Assisted homeowners have repaid $246 million to date, which works out to a $10 million profit for the state over a 25-year period of helping families keep their houses. To be eligible for HEMAP homeowners must be in default through no fault of their own and have a reasonable prospect of resuming their mortgage payments within 36 months. A recent paper from the Boston Federal Reserve also proposes helping homeowners who had a "significant income disruption" through bridge loans of up to 24 months.[34]

Several Members of Congress, including Chairman Frank, have embraced this concept. Chairman Frank's TARP for Main Street bill would provide $2 billion in TARP money to make loans to homeowners to help pay mortgages if they don't qualify for other assistance.

6. Transfer servicing to entities that don't have conflicts and automatically convert trial modifications into permanent modifications.

Since early 2007, mortgage loan servicers have been promising to help homeowners in trouble.[35] The Bush Administration believed that servicers would voluntarily provide this assistance because in so many cases, foreclosure made no economic sense for the lender or loan owner. Unfortunately, financial incentives for servicers often encourage

outcomes that are not advantageous either for the loan owner or for the homeowner.[36] What's more, like other players in the financial services industry, much of their income comes from fee-generating tricks and traps for consumers.

It is fully understood now that helping homeowners avoid foreclosure is frequently in conflict with the financial interest of servicers. Thus, the HAMP program provides servicers with financial incentives for placing homeowners into permanent loan modifications if the benefit (net present value) of the modification is higher than that of foreclosure. Unfortunately, so far, these financial incentives have not proven sufficient for servicers to process loan modification requests in a timely, effective manner.

There is now widespread recognition that most servicers in their current form lack the capacity to handle a foreclosure crisis of the size and scope we are seeing today. Servicers had to do a great deal of retooling, morphing from collection agencies to something a lot more like a lender as staff are now essentially required to do underwriting and have extensive customer contact. In the early months of the program, a great deal of latitude was given to servicers for their ramp-up time. However, capacity issues continue to persist, although it has been more than two years after widespread recognition of the foreclosure and nine months since the HAMP program began. Homeowners still have terrible trouble reaching their servicers, and when they do, they often encounter staff who are ignorant of the HAMP program, they sit through attempts to steer them into other products, and they are unable to get any firm decisions made in a timely manner. Scores of newspaper and radio articles have wondered why it is that servicers cannot seem to retool their businesses to handle the demands of this crisis.[37]

The perceived shortcomings of the mainstream servicing industry has led to significant growth in the number and size of so-called specialty servicers – businesses that specialize in intensive, "high-touch" approaches to working with homeowners in trouble. These specialty servicers are often able to reach homeowners at many times the rate of a mainstream servicer and in many cases are more skilled in dealing with families in crisis. Recently, Fannie Mae and Freddie Mac began to require their servicers who are not producing sufficient results to use specialty servicers for the delinquent accounts.

We think it would be useful to explore how and under what circumstances the Treasury Department could require HAMP-participating servicers to turn their accounts over to special servicers working for the government when the account becomes 60 days delinquent. However, it would be of the utmost importance to ensure that the specialty servicers are carefully monitored to ensure that a more aggressive approach does not violate consumer rights with respect to debt collection.

We also suggest that trial modifications to convert to permanent modifications automatically upon the successful completion of the trial period.[38]

7. Pass legislation mandating loss mitigation prior to foreclosure.

Even if the HAMP program is changed to prevent the filing of foreclosure prior to evaluation, Congress should make this requirement into a legal standard with a private right of action. The fact is, while HAMP servicers do have a contract with the Treasury Department, the servicers and the Treasury are the only parties to those contracts. Even if a servicer breaches the contract, the Treasury's primary remedy is to withhold incentive payments, which by and large are not yet emerging as a strong enough incentive to change servicer behavior. It is important to give homeowners a clear right to evaluation prior to foreclosure, and for many servicers, only a legal requirement will cause them to build the systemic safeguards necessary to ensure that such evaluations occur.

One such proposal is HR 3451, introduced this summer by Representative Maxine Waters. This bill would require loan servicers to engage in loss mitigation efforts prior to foreclosure without mandating any particular outcome or result. By requiring loan servicers to engage in loss mitigation prior to foreclosure, this legislation will assist homeowners, lenders, investors, and communities. However, HR 3451 needs to be extended to cover all loans, both prospectively and retroactively.

B. In addition, Congressional or Treasury action in several other areas would provide significant benefit in mitigating the crisis:

1. Provide an independent appeals process easily accessible by homeowners.

Effective January 1, Treasury will require servicers to promptly notify homeowners who are rejected for a HAMP modification and provide an explanation for why they have been rejected. This is a long overdue improvement, but homeowners who have been denied a loan modification or who are being foreclosed on in error still need access to an independent appeals process. Freddie Mac's compliance program aims to ensure that servicers abide by the program's guidelines, but it is not a process accessible by an individual homeowner. Treasury is allowing servicers to offer the HOPE hotline as a dispute resolution mechanism in their rejection letter to homeowners, yet as described, the HOPE hotline can only contact the servicer; it does not have any authority to enforce or monitor compliance with program requirements. Homeowners need access to an independent escalation process in addition to any internal review process they can access within the servicer.

Treasury is also allowing servicers to tell homeowners that they have been rejected for HAMP because the investor, mortgage insurer, or guarantor for their loan has refused to allow HAMP modifications – but there is no requirement to provide the name of that party or identifying what efforts the servicer made to obtain their permission. Without access to that information, homeowners and their advocates are unable to confirm that third-party restrictions truly are a roadblock to a HAMP modification—servicers sometimes will use "investor restrictions" as an easy scapegoat—and whether servicers

are complying with HAMP's requirement "to use reasonable efforts" to waive third-party restrictions.

2. Prohibit servicers from requiring homeowners to waive legal rights when receiving a modification.

We are pleased that the HAMP program guidelines prohibit servicers from requiring homeowners to sign sweeping waivers of legal rights in order to obtain a modification. At a hearing in July 2008, Chairman Frank spoke out strongly against such waivers, instructing servicers to stop using them. Unfortunately, despite consequent changes in official policy at many servicers, these waivers continue to arise.[39] The Treasury Department should immediately change its contracts to prohibit such broad waivers being used either in HAMP modifications or in other modifications or any other context by any HAMP-participating servicers. If this problem cannot be solved through HAMP, it might be necessary for Congress to act.

3. Permit homeowners who experience additional adverse life events to be eligible for additional HAMP modifications.

Even after a homeowner is paying their monthly payments due under a HAMP loan modification, life events may still occur that would further alter their ability to repay the loan, such as job loss, disability, or the death of a spouse. These subsequent, unpredictable events, outside the control of the homeowner, should not result in foreclosure if a further loan modification would save investors money and preserve homeownership. Foreclosing on homes where homeowners have suffered an involuntary drop in income without evaluating the feasibility of a further HAMP modification is punitive to homeowners already suffering a loss and does not serve the interests of investors. Some servicers provide some modifications upon re-default as part of their loss mitigation program; this approach should be standard and mandated, and should include continued eligibility for HAMP modifications rather than only specific servicer or investor programs.

4. Clarify that homeowners in bankruptcy are eligible for the HAMP program.

As a result of the HAMP guidelines providing servicer discretion on whether to provide homeowners in bankruptcy access to loan modifications under the program, homeowners generally are being denied such loan modifications. The HAMP guidelines should provide clear guidance on instances where a loan modification should be provided to homeowners in bankruptcy. The HAMP guidelines should explicitly provide that servicers must consider a homeowner seeking a modification for HAMP even if the homeowner is a debtor in a pending bankruptcy proceeding.

5. Ensure that homeowners receiving mortgage debt forgiveness or modifications do not find their new financial security undermined with a burdensome tax bill.

Finally, even principal forgiveness or the most carefully structured loan modifications can be seriously undermined if struggling homeowners must treat the forgiven mortgage debt as taxable income. Solving this tax problem has been flagged as a priority by the IRS's Office of the National Taxpayer Advocate.[40]

To describe the tax problem in brief, when lenders forgive any mortgage debt, whether in the context of a short sale, a deed-in-lieu-of-foreclosure, foreclosure, or principal reduction in a loan modification, that amount of forgiven debt is considered to be income to the homeowner and tax must therefore be paid on it unless the homeowner qualifies for some kind of exclusion to that tax. In 2007, Congress passed the Mortgage Forgiveness Debt Relief Act of 2007 to prevent adverse tax consequences to homeowners in trouble. After passage of this bill, most policymakers considered the problem to have been solved.

Unfortunately, because of the way that legislation was written, many homeowners still owe tax despite the Mortgage Forgiveness Debt Relief Act. That legislation defined "qualified mortgage debt" to include only that debt that was used to purchase a home or make major home improvements. In calculating the tax, any unqualified debt is first subtracted in its entirety from the amount of forgiven debt (not on a pro rate basis). In many cases, the amount of unqualified debt will equal or exceed the amount of debt forgiven, leaving the homeowner to pay tax on the entire forgiven debt – and even in those cases where the amount forgiven exceeds the amount of unqualified debt, the homeowner will still owe a large tax bill.

Expanding the definition will make it easier for everyone, even those homeowners already fully covered by the Mortgage Forgiveness Debt Relief Act, to take advantage of this exclusion. To take advantage of the mortgage debt exclusion, a homeowner now has to file a long-form 1040, along with a Form 982, a very complicated and difficult form. Unfortunately, most lower and middle income taxpayers are not accustomed to using these forms, and taxpayers filing long-form 1040s are not eligible to use the various tax clinics offered by the IRS and others for lower-income taxpayers. The National Taxpayer Advocate reports that last tax year, less than 1% of those eligible for the exclusion claimed it.[41] If the definition of qualified mortgage debt is expanded as described above, the IRS can take steps through its tax forms to simplify the process for taxpayers claiming the mortgage debt exclusion.

6. Create the Consumer Financial Protection Agency

In light of our research, we believe there are several important additional steps Congress should take to prevent reckless lending that could once again fundamentally disrupt our economy. Most importantly is the creation of the Consumer Financial Protection Agency, which this Committee has already reported out and which will considered by the full House of Representatives this week.

As demonstrated above, the subprime market itself delivered loans with significant inherent risks over and above borrowers' exogenous risk profiles through the very terms of the mortgages being offered. Although financial regulatory agencies were aware of this risk, regulatory action was discouraged by the concern that any regulatory agency taking action against these types of loans would place their regulated institutions at a competitive disadvantage. In addition, the ability of lenders to choose their regulator has resulted in a system where lenders may exert deep influence over their regulator's judgment.[42]

The Consumer Financial Protection Act would gather in one place the consumer protection authorities currently scattered across several different agencies, and would create a federal agency whose single mission is to protect our families and our economy from consumer abuse. The Agency would restore meaningful consumer choice by averting the race to the bottom that has crowded better products out of the market.[43]

The design of the Agency is appropriately balanced to enhance safety and soundness and allow appropriate freedom and flexibility for innovation while providing effective consumer protection. Highlights include the following:

- The Agency will have essential rule-making authority to prevent abusive, unfair, deceptive and harmful acts and practices and to ensure fair and equal access to products and services that promote financial stability and asset-building on a market-wide basis.

- The Agency will have strong enforcement tools, along with concurrent authority for the States to enforce the rules against violators in their jurisdictions.

- States will not be hamstrung in their efforts to react to local conditions as they arise and preserves the ability of states to act to prevent future abuses.

- The Agency will have access to the real-world, real-time information that will best enable it to make evidence-based decisions efficiently.

In other areas of the economy, from automobiles and toys to food and pharmaceuticals, America's consumer markets have been distinguished by standards of fairness, safety and transparency. Financial products should not be the exception – particularly since we have demonstrated that it is the subprime mortgage products themselves that raised the risk of foreclosure. A strong, independent consumer protection agency will keep markets free of abusive financial products and conflicts of interest. Dedicating a single agency to this mission will restore consumer confidence, stabilize the markets and put us back on the road to economic growth.

7. Prohibit predatory lending in the future, particularly unsustainable loans, yield spread premiums and prepayment penalties.

It is also imperative to pass legislation that would require sensible and sound underwriting practices and prevent abusive loan practices that contributed to reckless and unaffordable home mortgages. For this reason, we urge the passage of H.R. 1728. While there are some ways in which this bill should be strengthened, it represents a critical step forward in requiring mortgage originators to consider the consumer's ability to repay the loan and to refinance mortgages only when the homeowner receives a net tangible benefit from the transaction.

Most important, H.R. 1728 establishes bright line standards that will result in safer loans and in more certainty for originators of those loans. The bill's safe harbor construct would grant preferred treatment to loans made without risky features such as prepayment penalties, excessive points and fees, inadequate underwriting, and negative amortization. It would also ban yield spread premiums – which, as we explained earlier, were key drivers of the crisis – and it would permit states to continue to set higher standards if necessary to protect their own residents.

Similarly, we strongly support the Federal Reserve Board's proposal to ban yield spread premiums for all loan originators and prohibit steering consumers to unnecessarily expensive loans. The Board's proposed rule represents an important step forward in the recognition that disclosure alone is not enough to protect consumers and that certain practices themselves give rise to unfairness and unnecessary risk.

Many industry interests object to any rules governing lending, threatening that they won't make loans if the rules are too strong from their perspective. Yet it is the *absence* of substantive and effective regulation that has managed to lock down the flow of credit beyond anyone's wildest dreams. For years, mortgage bankers told Congress that their subprime and exotic mortgages were not dangerous and regulators not only turned a blind eye, but aggressively preempted state laws that sought to rein in some of the worst subprime lending.[44] Then, after the mortgages started to go bad, lenders advised that the damage would be easily contained.[45] As the global economy lies battered today with credit markets flagging, any new request to operate without basic rules of the road is more than indefensible; it's appalling.

Conclusion

Today's foreclosure crisis is arguably one of the most significant economic challenges this country has faced since the Great Depression, and the stakes are high. We know that this year alone, American households will lose $500 billion in equity as a result of foreclosures that happen to occur in their neighborhoods.[46] Additional spillover costs are

also significant, including cuts in community services and lower levels of consumer spending. As foreclosures mount, these related costs will only grow worse as well.

It is now clear that current prevention efforts alone will allow the current crisis to continue and fester, even under a best-case scenario. Some new approaches along with changes in the way the program is implemented could significantly strengthen foreclosure prevention and reduce associated losses. Many of the potential policy solutions we have discussed here are accessible, relatively simple to implement, and build upon efforts that are already underway. We urge you to act quickly and decisively.

---

[1] See, e.g., "Housing Starts and Vacant Units: No 'V'-Shaped Recovery, Calculated Risk (November 15, 2009), available at http://www.calculatedriskblog.com/2009/11/housing-starts-and-vacant-units-no-v.html; Dean Baker, testimony before the Congressional Oversight Panel "The Failures of TARP," (November 19, 2009).

[2] MBA National Delinquency Report, Nov. 19, 2009.

[3] Ruth Simon and James R. Hagerty, *One in Four Borrowers is Under Water*, Wall Street Journal (Nov. 24, 2009) ("The proportion of U.S. homeowners who owe more on their mortgages than the properties are worth has swelled to about 23%, threatening prospects for a sustained housing recovery. Nearly 10.7 million households had negative equity in their homes in the third quarter, according to First American CoreLogic, a real-estate information company based in Santa Ana, [California]").

[4] According to data from the Mortgage Bankers Association, since the first quarter of 2007 through the third quarter of this year, foreclosures starts are very clost to six million (5,954,800).

[5] Jan Hatzius and Michael A. Marschoun, *Home Prices and Credit Losses: Projections and Policy Options*, Goldman Sachs Global Economics Paper,(No. 177, Jan 13, 2009) at 16.

[6] Center for Responsible Lending, *Continued Decay and Shaky Repairs: The State of Subprime Loans Today*, p.2 (Jan. 8, 2009), p.3, *available at* http://www.responsiblelending.org/issues/mortgage/research/continued-decay-and-shaky-repairs-the-state-of-subprime-loans-today.html.

[7] It is popular, although incorrect, to blame the Community Reinvestment Act (CRA) and Fannie Mae and Freddie Mac (the GSEs) for the foreclosure crisis. For a complete discussion of why CRA and the GSEs did not cause the crisis, see Testimony of Eric Stein, Center for Responsible Lending, before the Senate Committee on Banking (Oct. 16, 2008), *available at* http://www.responsiblelending.org/pdfs/senate-testimony-10-16-08-hearing-stein-final.pdf.

[8] Rick Brooks and Ruth Simon, *Subprime Debacle Traps Even Very Credit-Worthy As Housing Boomed, Industry Pushed Loans To a Broader Market*, Wall Street Journal at A1 (Dec. 3, 2007).

[9] Letter from Coalition for Fair & Affordable Lending to Ben S. Bernanke, Sheila C. Bair, John C. Dugan, John M. Reich, JoAnn Johnson, and Neil Milner (Jan. 25, 2007) at 3.

[10] Julie Bykowicz, "City can proceed with Wells Fargo lawsuit", Baltimore Sun (July 3, 2009) (available at http://www.baltimoresun.com/news/maryland/baltimore-city/bal-md.foreclosure03jul03,0,5953843.story).

[11] *See e.g.,* Yuliya Demyanyk, "Ten Myth About Subprime Mortgages", Economic Commentary, Federal Reserve Bank of Cleveland (May 2009) (available at http://www.clevelandfed.org/research/commentary/2009/0509.pdf); Karen Weaver, "The Sub-Prime Mortgage Crisis: A Synopsis" Deutsch Bank (2008) (available at http://www.globalsecuritisation.com/08_GBP/GBP_GSSF08_022_031_DB_US_SubPrm.pdf) (concluding

that subprime mortgages "could only perform in an environment of continued easy credit and rising home prices);

[12] Lei Ding, Roberto G. Quercia, Janneke Ratcliff, and Wei Li, "Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models" Center for Community Capital, University of North Carolina at Chapel Hill (September 13, 2008) (available at http://www.ccc.unc.edu/abstracts/091308_Risky.php).

[13] Center for Responsible Lending, *Steered Wrong: Brokers, Borrowers and Subprime Loans* (April 8, 2008), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/steered-wrong-brokers-borrowers-and-subprime-loans.pdf.

[14] Center for Responsible Lending, *Steered Wrong: Brokers, Borrowers and Subprime Loans* (April 8, 2008), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/steered-wrong-brokers-borrowers-and-subprime-loans.pdf.

[15] The first two lines on this graph (unemployment and mortgage delinquency) were circulated by the Mortgage Bankers Association as an advocacy tool to demonstrate that unemployment rather than bad practices was responsible for the current foreclosure crisis. However, once foreclosure data is added to the chart, it is clear that the relationship did not exist during previous downturns.

[16] Similarly, the "cure" rate – the rate at which homeowners who are behind on their mortgages catch up rather than default – has plummeted to an astonishing 6.6 percent. See Fitch Ratings, Delinquency Cure Rates Worsening for U.S. Prime RMBS (Aug. 24, 2009).

[17] The refinancing portion of the Home Affordable initiative has also had somewhat more limited reach than had been anticipated. *See* news release from the Federal Housing Finance Agency (Nov. 2, 2009),

[18] According to the Congressional Oversight Panel, only 1,711 had been converted as of September 1, 2009. Recently, Tom Heinemann of the Office of Homeownership Preservation told an audience at a consumer conference that the number was now in the "tens of thousands," (Consumer Federation of American Conference, December 4, 2009).

[19] Wash Post 12/5/09

[20] See Testimony of Alys Cohen, National Consumer Law Center, before the House of Representatives Subcommittee on Housing and Community Opportunity of the House Committee on Financial Services, September 9, 2009.

[21] One Pennsylvania bankruptcy judge has recently provided troubling details of how "communications" between servicers and their outside law firms take place almost entirely through automated systems without any human interaction. In re Taylor, 407 B.R. 618 (E.D. Pa. 2009). That judge concluded, "The thoughtless mechanical employment of computer-driven models and communications to inexpensively traverse the path to foreclosure offends the integrity of our American bankruptcy system."

[22] This will be discussed in today's testimony by Laurie Goodman, Senior Managing Director, Amhert Securities Group LP.

[23] *See* note 3 above.

[24] Homeowners with equity in their homes are generally able to refinance into lower rate loans and are much less likely to get in a situation where they require assistance.

[25] Although many decry the phenomenon of "walkaways," when people voluntarily default on their mortgages, there are actually far fewer such walkaways than economic theory might predict. [cite] however, it is clear that at some level, the disincentive of being underwater will have an impact on the homeowner's success in continuing with the mortgage.

[26] Gretchen Morgenson, Why Treasury Needs a Plan B for Mortgages, New York Times (Dec. 5, 2009), citing a report by Laurie Goodman of Amherst Securities [hereinafter "Amherst study"].

[27] Amherst Study.

[28] Experian-Oliver Wyman Market Intelligence Report, *Understanding Strategic Default in Mortgages Part I*, Sept. 2009.

[29] OCC mortgage metrics Q2 2009.

[30] Servicers with large POARM books are moving many of these homeowners into 10 year interest-only loans, which is helpful in the short term but is ultimately only postponing the day of reckoning if the housing market does not enter another bubble period before 10 years is up.

[31] Mark Zandi, "Homeownership Vesting Plan", Moody's Economy.com (December 2008) (available at http://www.dismal.com/mark-zandi/documents/Homeownership_Vesting_Plan.pdf).

[32] *Lewis Ranieri to deliver Dunlop Lecture on Oct. 1*, Harvard University Gazette, Sept. 25, 2008, *available at* http://www.news.harvard.edu/gazette/2008/09.25/06-dunlop.html.

[33] Lewis S. Ranieri, "Revolution in Mortgage Finance," the 9th annual John T. Dunlop Lecture at Harvard Graduate School of Design, Oct. 1, 2008, *available at* http://www.jchs.harvard.edu/events/dunlop_lecture_ranieri_2008.mov (last visited Oct. 13, 2008). Ranieri, is "chairman, CEO, and president of Ranieri & Co. Inc. and chairman of American Financial Realty Trust, Capital Lease Funding Inc., Computer Associates International Inc., Franklin Bank Corp., and Root Markets Inc. He has served on the National Association of Home Builders Mortgage Roundtable since 1989. . . ." *Harvard University Gazette*, Sept. 25, 2008.

[34] Chris Foote, Jeff Fuhrer, Eileen Mauskopf, and Paul Willen, *A Proposal to Help Distressed Homeowners: A Government Payment-Sharing Plan*, Federal Reserve Bank of Boston Public Policy Briefs (No. 09-1) (July 9, 2009).

[35] Homeownership Preservation Summit Statement of Principles (May 2, 2007), http://dodd.senate.gov/index.php?q=node/3870/print (The Summit resulted in a statement of Homeownership Preservation Principles announced by Chairman Dodd, and endorsed by the Mortgage Bankers Association, CitiGroup, Chase, Litton, HSBC, Countrywide, Wells, AFSA, Option One, Freddie Mac, and Fannie Mae).

[36] Diane E. Thompson, *Why Servicers Foreclose When They Should Modify and Other Puzzles of Servicer Behavior*, National Consumer Law Center (Oct. 2009), available at http://www.nclc.org/issues/mortgage_servicing/content/Servicer-Report1009.pdf

[37] See, e.g., Chris Arnold, *Are There More Foreclosures Than Necessary?* National Public Radio Planet Money (May 15, 2009). http://www.npr.org/templates/story/story.php?storyId=104177396

[38] It might be useful to consider in what way housing counselors, consumer lawyers, and other trusted intermediaries can help move the loan modification process forward. The Center for American Progress has suggested these intermediaries should be empowered to place homeowners into trial modifications that would automatically convert to permanent modifications after 90 days unless the servicer object. We are

not certain whether it would be possible to accomplish this kind of transfer of authority under current contracts.

[39] Loan modification made by Wells Fargo, available on file at CRL.

[40] National Taxpayer Advocate, *2008 Annual Report to Congress*, p. 341, 391-396 ["NTA Annual Report"].

[41] NTA Annual Report, p. 394.

[42] *See e.g.*, Silla Brush, "Audit: OTS knew bank data was skewed", The Hill (May 21, 2009) (available at http://thehill.com/business--lobby/audit-ots-knew-bank-data-skewed-2009-05-21.html).

[43] *See* Center for Responsible Lending, Neglect and Inaction: An Analysis of Federal Banking Regulators' Failure to Enforce Consumer Protections (July 13, 2009) *available at* http://www.responsiblelending.org/mortgage-lending/policy-legislation/regulators/neglect-and-inaction-7-10-09-final.pdf.

[44] Id.

[45] For example, in September 2006, Robert Broeksmit of the Mortgage Bankers Association told Congress, "Our simple message is that the mortgage market works and the data demonstrate that fact," and "I strongly believe that the market's success in making these "nontraditional" products available is a positive development, not cause for alarm." Statement of Robert D. Broeksmit, CMB Chairman, Residential Board of Governors, Mortgage Bankers Association, Before a Joint Hearing of the Subcommittee on Housing and Transportation and the Subcommittee on Economic Policy, U.S. Senate Committee on Banking, Housing and Urban Affairs, Calculated Risk: Assessing Non-Traditional Mortgage Products, *available at* http://banking.senate.gov/public/_files/broeksmit.pdf./. In May 2007, John Robbins of the Mortgage Bankers Association said, "As we can clearly see, this is not a macro-economic event. No seismic financial occurrence is about to overwhelm the U.S. economy. And we're not the only ones who think so." John M. Robbins, CMB, Chairman of the Mortgage Bankers Association at the National Press Club's Newsmakers Lunch – Washington, D.C. , *available at* http://www.mortgagebankers.org/files/News/InternalResource/54451_NewsRelease.doc.

[46] "Soaring Spillover Cost of Foreclosures," Center for Responsible Lending, available at http://www.responsiblelending.org/mortgage-lending/research-analysis/soaring-spillover-accelerating-foreclosures-to-cost-neighbors-436-billion-in-2009-alone-73-4-million-homes-lose-5-900-on-average.html.

EMBARGOED UNTIL DELIVERY

STATEMENT OF

MICHAEL H. KRIMMINGER
SPECIAL ADVISOR FOR POLICY
OFFICE OF THE CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

on

THE PRIVATE SECTOR AND GOVERNMENT RESPONSE TO THE MORTGAGE FORECLOSURE CRISIS

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

December 8, 2009
2128 Rayburn House Office Building

Chairman Frank and Ranking Member Bachus, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) regarding the private sector and government response to the mortgage foreclosure crisis. My testimony will focus on the FDIC's efforts to promote financial stability by identifying and implementing sustainable solutions to preserve homeownership. I will describe the rationale for these efforts, the process by which we developed our modification proposals, our loan modification program at IndyMac Federal Bank, and our ongoing efforts to promote loan modifications through our roles as bank supervisor and as receiver for failed banks. I will close by outlining some lessons learned in this process that may be useful in furthering private and public loan modification efforts in the future.

Background

The Crisis in Homeownership. Before and during the financial crisis, the FDIC has acted on a number of fronts to preserve public confidence in banking and to restore the strength of our financial markets and institutions. Early on, Chairman Bair expressed concern about consumer protection abuses and distortions in our housing and mortgage markets. To respond to those problems, the FDIC proposed specific action to strengthen consumer protection, address problems in mortgage underwriting and prevent avoidable foreclosures.

There is no question that mortgage credit distress and declining home prices have been fundamental sources of uncertainty for financial markets and institutions in this

crisis. According to the Standard and Poors/Case-Shiller home price index for 10 large U.S. cities, average U.S. home prices rose by 192 percent in the 10 year period ending in mid-2006, and have fallen by a net total of 31 percent since that time. Home price declines in some of the hardest hit metropolitan markets now approach or exceed 50 percent from peak levels. The combination of far too many structurally unsound mortgages and historic home price declines – which precluded refinancing – led to historic increases in mortgage defaults and foreclosures. Total U.S. foreclosures rose from around 938,000 in 2006 to 1.5 million in 2007 and 2.3 million in 2008.[1] Despite increased efforts this year to modify delinquent and at-risk mortgages, the number of homes entering foreclosure in the first three quarters of 2009 exceeded 2.2 million. However, as troubling as these statistics are, they only provide a pale reflection of the devastating personal consequences of this crisis for millions of Americans and their communities.

Meetings with Servicers and Investors. As the crisis began to unfold in early 2007, some questioned whether restructuring for troubled mortgages was even possible under the pooling and servicing agreements (PSAs) that controlled servicing for millions of securitized mortgages. To answer these questions, in April 2007, the FDIC began hosting discussions with a range of mortgage servicers, investors, accountants, attorneys, and regulators to identify impediments and explore avenues to restructure problem loans instead of foreclosing. We learned that most PSAs provide considerable leeway for modifications. Similarly, according to the participants, applicable accounting rules and

[1] FDIC estimates based on data from the Mortgage Bankers Association (National Delinquency Survey) and the U.S. Department of Housing and Urban Development (American Housing Survey).

the requirements for Real Estate Mortgage Investment Conduits (REMICs) do not generally preclude modifications for mortgages that are either in default or where default is reasonable foreseeable. The key requirement for the servicer modifying the troubled mortgage was that by modifying, instead of foreclosing, the servicer would maximize the expected net present value (NPV) of the mortgages. In a declining housing market with growing losses in foreclosure, a sustainable modification of the mortgage frequently provided better value than foreclosure and was well within the power of servicers. These lessons were later confirmed in guidance provided by leading accountants, the SEC, and mortgage industry associations. Later in 2007, the federal banking regulators provided guidance to insured banks and thrifts confirming that modifications normally were permitted by applicable standards.[2]

Early Efforts by the FDIC to Promote Loan Modifications on a Mass Scale. In a *New York Times* op-ed published in October 2007, FDIC Chairman Sheila Bair summarized the problems facing subprime borrowers and the potential benefits of restructuring at-risk loans where borrowers were facing large resets in their interest rate and monthly payment.[3] Chairman Bair's proposal rested on two premises: 1) that most subprime borrowers could not afford the large increases in their monthly payment after reset, and 2) that simply foreclosing on defaulted loans would only add to the excess

[2] July 24, 2007 Letter from SEC Chairman Christopher Cox to Chairman Barney Frank of the House Financial Services Committee; 2007 Mortgage Bankers Association, Position Paper, "FAS 140 Implications of Restructuring of Certain Securitized Residential Mortgage Loans"; Real Estate Mortgage Investment Conduit regulation at 26 CFR 1.860G-2; American Securitization Forum Statement of Principles, Recommendations and Guidelines for the Modification of Securitized Subprime Residential Mortgage Loans, June 2007 at 2; Sept. 4, 2007 Interagency Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages.

[3] Sheila C. Bair, "Fix Rates to Save Loans," *New York Times*, October 19, 2007, http://www.nytimes.com/2007/10/19/opinion/19bair.html

supply of housing, push down home prices, and make the mortgage credit problem worse. The proposal relied upon the fundamental obligation of servicers to maximize the value of the securitized loans for investors. Where mortgage restructuring is the best strategy to do this – as shown by a well-developed NPV analysis – then servicers should modify the loan rather than foreclose. Unfortunately, as the crisis has shown, there are many contradictory incentives in the servicers' role and in the structure of securitizations that complicate this beneficial result. Going forward, these misaligned incentives should be addressed in the structure of future securitizations.

Loan Modification at IndyMac Federal Bank. The FDIC was soon faced with the need to implement these principles when it was named conservator for IndyMac Federal Bank, F.S.B., Pasadena, California on July 11, 2008. At IndyMac, the FDIC inherited responsibility for servicing a pool of approximately 653,000 first lien mortgage loans, including over 60,000 mortgage loans that were more than 60 days past due, in bankruptcy, in foreclosure, or otherwise not currently paying. Of the entire pool of mortgages serviced by IndyMac, only 7 percent were owned by the institution, while the remaining 93 percent were serviced for other owners through securitizations, whole loan sales, or through loans owned by Freddie Mac and Fannie Mae. As conservator, the FDIC had the responsibility to maximize the value of the loans owned or serviced by IndyMac Federal. Like any other servicer, IndyMac Federal was obligated to comply with its contractual duties in servicing loans owned by investors. Consistent with these duties, we implemented a loan modification program to convert as many of these distressed loans as possible into performing loans that were more affordable and

sustainable over the long term where doing so would maximize the NPV of the mortgages. In addition, we sought to refinance distressed mortgages through FHA programs, including FHA Secure and HOPE for Homeowners, and have sent letters proposing refinancing through FHA to thousands of borrowers.

The FDIC program for residential borrowers with mortgages owned or serviced by IndyMac Federal modified eligible, delinquent mortgages to achieve affordable and sustainable payments using interest rate reductions, extended amortization and, where necessary, a partial deferral of principal. Modifications were only undertaken if doing so would maximize the NPV return. By modifying the loans to an affordable debt-to-income ratio and using this menu of options to lower borrowers' payments, the program improved the value of these troubled mortgages while achieving economies of scale for servicers and stability for borrowers. Of the more than 60,000 mortgages serviced by IndyMac Federal as of August 2008 that were more than 60 days past due or in foreclosure, approximately 40,000 were deemed potentially eligible for our loan modification program.[4]

Since the inception of the IndyMac modification program in August 2008, over 23,500 borrowers have received a modification. Approximately 12,507 of these were completed between August 2008 and the FDIC's sale of IndyMac to OneWest Bank in March 2009. Of the modifications completed since March, only about 1,200 modifications are subject to the loss share agreement with OneWest Bank, described

[4] Loans not eligible for a modification proposal under the IndyMac Federal modification program included non-owner-occupied loans, loans subject to bankruptcy proceedings, completed foreclosures, and loans secured by properties held after a prior foreclosure.

below. Almost all of these modifications reduced the borrower's monthly payment by 10 percent or more. Through September 30th, only 25 percent of modified loans were 60 days or more past due or in foreclosure. In fact, since the applicable debt-to-income ratio for modified mortgages was reduced from 38 percent to 31 percent, the month-over-month redefault rate has dropped despite rising economic distress in many areas where IndyMac had been active.

Using the model at IndyMac Federal to achieve mortgage payments for borrowers that are both affordable and sustainable, the distressed mortgages could be rehabilitated into performing loans, thereby avoiding unnecessary and costly foreclosures in many cases. By taking this approach, future defaults could be reduced, the value of the mortgages could be improved, and servicing costs could be cut.

Development of the "Mod-in-a-Box". Based on the experience gained at IndyMac, the FDIC published last Fall a practical guide to implementing a loan modification program, which we call "Mod-in-a-Box."[5] This guide provides advice for servicers seeking to implement their own modification programs, including information on communicating with borrowers, determining eligibility, verifying income, structuring the modification, applying the NPV test, and reporting on program results. This publication represented our attempt to help servicers move forward in implementing their own modification programs with the benefit of our experience at IndyMac.

[5] See: FDIC Loan Modification Program Guide – "Mod in a Box" http://www.fdic.gov/consumers/loans/loanmod/loanmodguide.html

Proposal for Federal Incentives to Promote Modifications. The Emergency Economic Stabilization Act (EESA), which became law in October 2008, specifically provided the Secretary of the Treasury with authority to use loan guarantees and credit enhancements to facilitate loan modifications to prevent avoidable foreclosures. In response, the FDIC last fall proposed to Treasury a program of servicer incentives to promote the modification of distressed mortgages. The proposal would have used the techniques used at IndyMac to achieve modifications.[6] This approach resembles the loss sharing agreements that the FDIC has used for years to induce failed bank acquirers to maximize collections on receivership assets. While modifications would not solve the problems of every borrower, the modification and incentive process could be streamlined to reach many distressed borrowers and potentially help stabilize U.S. housing and mortgage markets.

Early this year, the FDIC and other agencies assisted in developing a Treasury program of incentives for the systematic modification of delinquent and at-risk mortgage loans, the Home Affordable Modification Program (HAMP). The HAMP reflects a number of concepts originally introduced by the FDIC at IndyMac, particularly with regard to the focus on a target debt service-to-income ratio of 31 percent and the steps taken to adjust the loan terms. These steps are: interest rate reduction, term extension, and principal forbearance as necessary in order to reduce the borrower's monthly payment to this target level. In other respects, however, the design of the HAMP incentive structure goes somewhat beyond the simple loss sharing approach that we

[6] See: "Loss Sharing Proposal to Promote Affordable Loan Modifications," http://www.fdic.gov/consumers/loans/loanmod/

proposed last Fall. For example, the HAMP includes more complex financial incentives than the loss sharing approach proposed by the FDIC. HAMP also includes multiple documentation requirements for income verification compared to the FDIC's approach at IndyMac. While this has the merit of providing more certainty regarding income levels, it can slow completion even of performing trial modifications while documents are reviewed and exchanged. FDIC analysts have continued to assist the inter-agency working group in providing suggestions for estimating model parameters and working out some of the details of implementation. While the FDIC has no role in decision-making or overall implementation for the HAMP, the FDIC strongly supports the goals embodied in the HAMP of achieving mortgage modifications to avoid unnecessary foreclosures.

Ongoing FDIC Efforts to Encourage Loan Modifications

Supervisory Efforts. In its role as a federal banking regulator, the FDIC supports prudent workout arrangements through its examination review process since sustainable loan modifications are generally in the long-term best interest of both the financial institution and the borrower. The community-based institutions that the FDIC supervises are engaging in loan modifications and avoiding foreclosure whenever possible. Most of these institutions have relatively small portfolios of residential loans. Based on the FDIC's reviews to date, FDIC-supervised institutions are implementing appropriate policies and procedures for ensuring that residential mortgage modifications

follow prudent underwriting standards and result in sustainable obligations based on the borrower's ability to repay.

The FDIC's examination process includes reviews of the loan modification programs of FDIC-supervised institutions to ensure that the criteria they are using are both reasonable and consistently applied. The FDIC also created a special training video for examiners that discusses prudent loan modifications. Along with the other banking agencies, the FDIC has provided guidance to its examiners supporting prudent loan modifications and confirming that examiners should not criticize institutions for engaging in loan modifications.[7] In addition, the FDIC has issued examiner guidance emphasizing the need to address second liens in order to provide a sustainable total mortgage obligation to borrowers.[8] To further encourage safe and sound modifications, institutions may receive favorable Community Reinvestment Act consideration for implementing these programs.[9]

Modification Efforts in Loss Share Agreements and Other Transactions. Over the past year, as the number of bank failures has risen, the FDIC has incorporated loss share agreements with purchasers of failed bank assets. Through November 20, 2009, the FDIC had loss share agreements in place for 81 failed bank resolutions that

---

[7] FDIC Financial Institution Letter FIL-35-2007, *Statement on working with Mortgage Borrowers*, dated April 2007, available at: http://www.fdic.gov/news/news/press/2007/pr07032a.html and FIL-76-2007, *Statement on Loss Mitigation Strategies for Servicers of Residential Loans*, dated September 2007, available at: http://www.fdic.gov/news/news/financial/2007/fil07076a.html.

[8] FDIC Financial Institution Letter FIL-45-2009, *Support for Responsible Loss Mitigation Activities Servicers' Obligations to Lienholders on Modifying Loans*, dated August 2009, available at: http://www.fdic.gov/news/news/financial/2009/fil09045.html.

[9] See the section entitled "Supervisory Guidance" at: http://www.fdic.gov/consumers/loans/prevention/fi.html

covered over $40 billion in single family loans. Under these agreements, the loans are sold to private buyers, who service and manage the loans, and share losses and recoveries with the FDIC.

Each of these loss sharing agreements requires that the purchasing institutions apply either the FDIC loan modification program, modeled on that developed at IndyMac, or the HAMP. To encourage sustainable loan modifications, the loss share agreements provide that the FDIC will share with the purchasers the losses on any modifications, including any losses incurred from a subsequent default on the modified mortgage. All mortgages on owner-occupied properties that are 60 days or more delinquent or considered at risk of default must be considered for modification and, if the NPV analysis shows that a modification is less costly than foreclosure, the purchaser must pursue a modification.

The FDIC loan modification program is very similar to HAMP since the techniques for loan modifications are modeled on the FDIC's IndyMac program, although the FDIC loan modification program does not offer federally-funded incentives. Like HAMP, the borrower's monthly payment after modification must not exceed 31 percent of the borrower's gross income. To reach that affordability hurdle, the institution is instructed to first reduce the interest rate to as low as 3 percent, then increase the term of the loan by up to 10 years, and finally forebear principal as necessary to achieve the borrower's affordable payment. All modifications result in amortizing payments with a fixed-payment period of 5 years. After 5 years, the interest rate may increase by up to 1

percent per year until attaining the Freddie Mac Primary Mortgage Market Survey rate (PMMS) – which is a prime mortgage rate (currently the PMMS is about 4.84 percent). Thus the borrower's payment schedule is known at the time of modification and the loan interest rate is capped at prime market rates at the time of the modification.

The vast majority of residential mortgages under loss share agreements are concentrated in three loss share partners: US Bank, OneWest Bank, and BankUnited. In each case, the FDIC is actively monitoring and auditing compliance with the loss share agreements, including performance under the requirement to modify mortgages.

In November 2008, Downey Savings & Loan and PFF Bank were acquired by US Bank, with loss share coverage provided for over $12 billion of single family mortgage assets. US Bank has implemented a modification program structured by the FDIC modification guidelines. Through September, these institutions had modified the terms of over 2,000 loans with approximately 1,500 loans or 22 percent of these institutions' loans that were 60 days or more past due in the process of being considered for modification.

In March 2009, OneWest Bank acquired IndyMac under a loss share agreement that covered $12.7 billion in single family mortgage assets. While OneWest continues to service a much larger pool of mortgages under servicing agreements assumed from IndyMac, only approximately 7 percent of the mortgages serviced by OneWest are covered by the loss share agreement. Under this agreement, the FDIC requires OneWest

to apply either the FDIC loan modification program or HAMP. Following the sale, OneWest continued to modify mortgages under the FDIC program – with more than 1,200 modifications completed through September. During August 2009, OneWest transitioned to the HAMP and has begun modifying loans under that program. As of September 30th, 327 loans covered by the loss share agreement were in the process of modification. The FDIC recently began a full-scope audit of OneWest's performance under the loss share agreement to provide a detailed analysis of its performance.

In May 2009, the FDIC executed a loss share agreement for the BankUnited receivership that added an additional $9.7 billion to the portfolio of single-family mortgage assets covered by these agreements. BankUnited recently completed its HAMP application and is in the process of modifying 2,643 loans, or 16 percent of the loans that were 60 days or more past due as of September.

The FDIC encourages all of its loss share agreement partners to proactively seek alternative solutions to minimize loss and encourage homeownership. We begin working with these institutions as soon as the agreements are in place. The FDIC is actively considering several changes to the FDIC modification program to better respond to changing economic and housing market conditions.

Separate from the FDIC's closed bank transactions, the FDIC, along with Treasury and the Federal Reserve, also required Citigroup to apply sustainable mortgage modifications to limit potential losses from foreclosure as part of the November 2008

agreement with Citigroup. Under this agreement, Citigroup bears first loss on an initial pool of $300.7 billion in assets, including $175 billion in single family mortgages, with the Treasury, FDIC, and Federal Reserve providing back-up loss sharing. As part of the agreement, Citigroup initially was required to apply the FDIC loan modification program and now is applying HAMP. It also permits Citigroup to continue certain other programs designed to address temporary job loss through temporary forbearance. From January through September 2009, Citi reports completing over 30,000 HAMP modifications, with an additional 28,000 trials underway. Citi has reported providing various temporary relief and incentive programs to 92,000 borrowers.

Recent Directions for Mortgage Relief

The causes of the continuing mortgage distress and the challenges in responding to it have evolved during the crisis. The original challenges facing subprime borrowers in 2007 arose from unaffordable payments following resets after a 2- to 3-year introductory period. Affordability continues to be a major problem because too many mortgages were originated at very high debt-to-income ratios or included payment option features that often led to large negative amortization and to future resets to unsustainable payments. Continuing declines in housing values along with such negative amortization features in many so-called "Alt-A" mortgages have placed increasing numbers of homeowners deeply underwater. Unfortunately, the recession and rising unemployment have now added new challenges.

Home price declines since 2006 have pushed as many as a quarter of U.S. mortgage borrowers "underwater," owing more than the current value of their homes.[10] In the hardest hit markets, borrowers with loans originated between 2005 and 2007 may be underwater by 50 percent or more. Because of the disincentives to repay created by large negative equity positions, the FDIC is now working to include principal forgiveness as an option available to loss share partner institutions for qualifying borrowers which continue to perform post-modification. Adding principal forgiveness to the range of options available to our loss share partners is a prudent work out mechanism as long as it maximizes the overall value of the loan. Under this approach there would be financial incentives under loss share, particularly for deeply underwater loans, to forgive some portion of the principal outstanding in order to maximize the value of the mortgage and provide long term sustainable mortgage payments for the borrower.

With unemployment now at 10 percent for the first time in 26 years, job loss has become a major driver of mortgage default. Some 7.3 million jobs have been lost since the start of the recession in December 2007, with three-quarters of these job losses occurring in just the past 12 months. This is why the FDIC issued a statement in September urging its loss share partners to adopt a temporary forbearance plan for unemployed borrowers, reducing their loan payment to an affordable level for at least six months.[11] This initiative focuses on the short-term distress of job loss as opposed to the long-term distress of an unaffordable loan.

---

[10] Economy.com estimates that some 15.6 million U.S. mortgage loans were underwater as of September 2009.

[11] See "FDIC Encourages Loss-Share Partners to Provide Forbearance to Unemployed Borrowers," http://www.fdic.gov/news/news/press/2009/pr09167.html

Lessons Learned

The FDIC's experience at IndyMac and with our loss share agreements has provided us with a number of lessons learned that we would like to share with the Committee.

Modifying early gives the best chance of success. Based on our experience at IndyMac, as well as feedback from other servicers, successful modifications are more likely if the borrower can be contacted and the modification completed before there is an extended period of delinquency. A proactive approach by servicers both to contact borrowers and to efficiently follow-up to complete the modification is essential. At IndyMac, indications are that the redefault rates on the initial modifications will exceed redefault rates on later modifications partly because many of the early modifications at IndyMac were performed on loans that had already been delinquent for many months before modification. Also, redefault rates improved as the modification program seasoned, business process improved, and IndyMac was able to more effectively and efficiently reach out to borrowers recently delinquent on pre- and post-modified loans.

Not surprisingly, the more affordable the modification, the lower the redefault rate. Another factor that clearly influences redefault rates is the affordability of the monthly payment. Current experience shows that redefaults on modifications targeted at the debt-to-income ratio of 31 percent eventually adopted at IndyMac have been considerably lower than reported by many other servicers. A 31 percent DTI ratio is also used in HAMP. The reason is that many of the earlier modifications by other

servicers actually *raised* the monthly payment of borrowers. High redefault rates on these 'modifications' are not surprising.[12]

Communication and follow-through with borrowers is critical. To address problems in reaching delinquent borrowers, the FDIC took the approach at IndyMac of sending out modification proposals that specify a dollar amount in projected monthly savings. This resulted in response rates well above industry norms in similar situations. A reliable process for follow-up communications and document processing is also essential to keeping borrowers engaged in the process. This requires creation of an effective information technology infrastructure and thoroughly staff training to provide accurate and consistent information to borrowers. Continuing follow-up with borrowers, especially if they should miss a payment, is particularly important.

Close working relationships with HUD-approved counseling groups will improve borrower response and modification success. Another important technique is to work closely with certified homeownership counseling groups. At IndyMac, the FDIC initiated agreements with many counseling groups to create a close working relationship to achieve more effective outreach to borrowers and assistance in completing modifications. These groups often have much greater credibility with borrowers than do servicers. In return, the FDIC paid counseling groups $500 for each completed modification. This is clearly a win-win option both for servicers and for counseling groups. Equally importantly, counselors can help borrowers prepare monthly

[12] "Perfection Isn't Modification's Aim," Letter to the Editor of the Wall Street Journal, June 5, 2009, http://www.fdic.gov/news/letters/lte_06052009.html

budgets and provide other guidance that will improve the likelihood that borrowers will be able to continue timely payments on their mortgages.

Consumer protection is critical to effective loan modifications. One of the principal lessons of the mortgage crisis has been the need for more effective consumer protection to help borrowers make informed choices. Complex mortgage features, such as payment options, negative amortization resets, and underwriting loans only at the initial 'teaser' rates, as well as the complexity of many disclosure documents provided an opportunity for unscrupulous operators to take advantage of borrowers. It is essential that our mortgage markets have common rules to protect consumers whether they do business with a bank or a non-bank lender, and the FDIC has supported creation of the Consumer Finance Protection Agency to help ensure this.

Today, we have seen a growing number of scams seeking to take advantage of desperate homeowners. Along with many state and federal agencies and private groups, the FDIC is working to ensure these scams are stopped and that borrowers get the help they need from reliable sources. In September, the FDIC published a brochure entitled, "Beware of Foreclosure Rescue and Loan Modification Scams" that offers tips on detecting fraudulent deals as well as resources for reporting criminal activity. [13]

Lenders and servicers must be flexible to address new challenges. As we have discussed, modifications and refinancing are valuable tools where affordability is the

[13] FDIC, "Beware of Foreclosure Rescue and Loan Modification Scams," http://www.fdic.gov/consumers/loans/prevention/rescue/index.html

primary problem. However, if the problem is caused by job loss or deeply underwater loans, lenders and servicers must respond with new approaches. The FDIC has strongly recommended adoption of forbearance programs for borrowers who have lost their jobs. This will provide an opportunity for borrowers to get another job and have sufficient income to support a more permanent solution. Similarly, principal forgiveness must be included as an option to address the increased risk of redefault on modifications for severely "underwater" loans.

Keep it simple. Modification programs must be relatively straightforward if servicers are to be able to apply a streamlined approach and if borrowers are to understand their options. While multiple layers of checks or multiple modification programs may, sometimes, appear to provide additional protections or flexibility, the benefits gained are often outweighed by the impediments created to rapid and effective implementation.

Conclusion

Throughout the financial crisis, the FDIC has worked closely with consumers, mortgage market participants and state and federal officials with the goal of reducing unnecessary losses of homeownership and its concomitant consequences of spreading economic distress. Loan modification, refinancing, temporary forbearance for out-of-work borrowers, and principal reductions are all tools to achieve these goals. We continue to support Treasury's HAMP as the best way to make affordable mortgage

modifications available to distressed borrowers across the wide spectrum of different mortgage lenders and servicers that manage their loans. As we know Treasury agrees, flexibility is vital if we are to achieve the overriding goal of preventing unnecessary foreclosures and their continuing economic consequences.

Above all, the FDIC remains committed to achieving what has been our core mission for over 75 years – protecting depositors and maintaining public confidence in the financial system.

I will be pleased to answer any questions the Committee might have.

Testimony of Bruce Marks, NACA CEO
House Financial Services Committee
Private Sector & Government Response to the Mortgage Foreclosure Crisis
December 8, 2009

My name is Bruce Marks. I am the Chief Executive Officer of NACA (Neighborhood Assistance Corporation of America). Founded in 1988, NACA is a national non-profit community advocacy and homeownership organization. NACA is known for its "Best in America" mortgage program for both homebuyers and homeowners. For homebuyers, NACA offers low and moderate income Americans home mortgages with a low fixed interest rate, no down payment nor closing costs. For Homeowners, NACA has established the most effective program in providing long-term affordable solutions for homeowners with an unaffordable mortgage payment. NACA has 38 offices nationwide and two national call centers. All of NACA's services are FREE.

NACA has now established the national standard in providing long-term affordable solutions for homeowners with an unaffordable mortgage. Over the past two years NACA's historic "Save the Dream Tour" has brought many thousands of homeowners, hundreds of counselors and Servicers/Lenders together to permanently restructure mortgages to what the homeowner can afford, often in one day. It has been an incredible success with hundreds of thousands of homeowners attending in 13 cities and thousands of homeowners receiving same day solutions. The tour will continue next year, expecting to reach 30 cities. We are determined to make the NACA standard the national standard. NACA is the most successful model.

These Save the Dream events are spectacular. They destroy the myth that mortgages cannot be made affordable and that it is a difficult process. We often get it done in one day. These events last over four to five days. There are over three hundred NACA counselors, hundreds of staff from all the major servicers, representatives from Fannie Mae, Freddie Mac and HUD, and hundreds of volunteers to provide logistical and operational support. Tens of thousands of people participate at each of these events and often there are thousands who sleep outside in order to be the first ones in. Counseling begins at 8:00 a.m. and often continues beyond 1:00 a.m. the next morning.

The counselors and Servicers utilize NACA's state-of-the-art web-based software called the NACA-Lynx. Once the counselor completes a counseling session, the complete file identifying the affordable payment with the documented income, hardship affidavit, tax authorization and other HAMP required documents are submitted in real-time to the Servicers. The file is then accessed by the Servicer's underwriters off-site as well as the Servicer's staff on-site. The homeowner then goes to meet with their Servicer on site to get their solution. This occurs in many cases.

Many homeowners have had their mortgage payments permanently reduced by over $500, and many by over $1,000 a month. Often the interest rates are permanently reduced to 3% or 2% and sometimes a principal reduction. NACA has achieved this through legally binding agreements with all the major Servicers: Bank of America, Chase, Wells Fargo, Citibank,

GMAC, Saxon, Litton, OneWest, AHMSI and HSBC as well as investors like Fannie Mae and Freddie Mac. The NACA agreement provides for two viable solutions to alleviate the foreclosure crisis for at-risk homeowners. One is a permanent restructure that provides homeowners with an affordable payment through either interest rate reduction to as low as 2% fixed for the life of the loan (no more than 30 years) and/or, a principal reduction/forbearance. The other solution is a forbearance agreement in which a homeowner who is unemployed without stable income would make a minimum payment every month for up to six months (in some cases longer) until they obtain additional income.

With the huge number of homeowners in the NACA program we are able to identify which Servicers and investors are providing long-term affordable solutions and where are the problems. The homeowners are dissatisfied with the traditional HAMP solution since they are determined to have a permanent payment without future increases or an extension of the term. They do not want a mortgage payment where there is a built-in payment shock. A mortgage payment that does not increase and is fully amortizing for less than thirty years is crucial, particularly when the outstanding principal is greater than the value of the property.

Also, FHA and VA loans are extremely problematic. It is outrageous that homeowners with a predatory mortgage from the private sector can get a better solution than a homeowner with a government mortgage even when the homeowner is a veteran. FHA uses a different version of HAMP which has not produced many long-term affordable solutions. It does not allow a borrower to get an interest rate below the FHA market rate (estimated around 5% as of Dec. 8, 2009) and any principal changes must be repaid at a later date. It is outrageous that the government has come up with a modification program to get borrowers an interest rate as low as 2% on non-FHA loans, but a government insured loan cannot achieve this.

The two major Servicers on this panel reflect the range of effectiveness in addressing the foreclosure crisis. JP Morgan Chase is the worst in this regard. They are extremely disorganized. They are impossible to work with and the homeowners hate working with them. While Chase was one of the first Servicers to offer trial modifications, they have not been able to provide long-term affordable solutions. They do not underwrite their files in the beginning of the process and wait at least three months to finalize the mortgage. They underwrite files with an originators mindset in that they are looking for a reason to say no. In fact in November, Chase has revealed that close to a quarter of trial modifications have been unsuccessful, as they have yet to receive even one payment from their borrowers, and almost half have been unsuccessful in making all three payments[1]. Also only a quarter of Chase's customers who have made all three payments have also sent in all the mandatory documents. Chase is a disaster.

On the other hand, Bank of America is one of the best in providing permanent modifications and accomplishing it in an efficient manner. At NACA's "Save the Dream" events, which happen throughout the country, they often approve permanent restructures/modification the same day. They even print and notarize the restructure agreement that same day so homeowners have proof of a permanent solution while they are at the "Save the Dream" event.

The government's response to the foreclosure crisis has been a failure. There are many reasons why HAMP is failing but the major reason is the business model and mindset of the Servicers. Servicers are effective at collecting and remitting payment to the investors. They, however, are NOT able to handle the huge volume of restructures/modifications that need to be done in order to stem the foreclosure crisis. Restructuring a mortgage it is more like originating a loan and Servicers do not have the systems or the trained staff to accomplish this effectively. In addition, they do not believe it is in their financial interest to do so.

Even though the Obama administration has incentivized Servicers (up to $4,500 per loan), the Servicers are not sufficiently motivated to permanently modify loan because of the extra cost of staff, overhead and the computer technology to do modifications. On the other hand, NACA has created state-of-the-art computer technology that currently provides the platform for the all the major Servicers. NACA provides solutions for homeowners, provides borrowers with up-dates including requests for additional document requirements and the ability to track the process. NACA does all the work for the Servicers, which helps reduce much of their costs, so there is no excuse for Servicer's working with NACA that they can't do more permanent solutions. What the Servicers lack is will and motivation.

Another problem is the Pooling and Servicing Agreements (PSA)'s that govern the rules between Servicers and investors. There needs to more transparency with the PSA's. Many times a servicer will say the investor does not allow a sustainable modification, but there is no recourse for the homeowner to follow up to see what the true facts are. The Servicer does not communicate with the investor (Pimco, Fortress, etc) to get a clarification of what they can offer a borrower. They rely on the master trustees who are part of the major lenders/servicers (Chase, Wells Fargo, etc.). Attorney guidance for these master trusts is risk adverse, and many times they proceed towards a foreclosure. PSA's often mandate that Servicers initiate a foreclosure sale while simultaneously attempting a modification, therefore creating confusion among homeowners[2]. In addition, many investors are advocating for principal reductions which the Servicers refuse to do. The Servicers do not want to set a precedent on the true value of their mortgage assets. This would require additional capital as well as highlighting the weaknesses of the major financial institutions in this country.

Second mortgages are also a problem. Chase, Wells Fargo, Bank of America and Citigroup own $442 Billion in second mortgages[3]. They are also the biggest Servicers of first mortgages in the country. The U.S. Department of Treasury is working with these institutions to accelerate the rate of modifications, but many of the loans that need to be modified also have these 2nd mortgages. These large banks have no interest in writing down the value of 2nd mortgages because of balance sheet impairment.

What should we do? As a former regulator at the Federal Reserve Bank, I understand the regulatory process and the power of the regulators. The Federal Reserve, OCC, FDIC and OTS must require Servicers to make every effort to provide a solution for the borrower: either a restructure/modification or forbearance. They also need to require principal reduction. With so many mortgages greater than the value of the house, only significant principal reduction can stem the foreclosure crisis and reestablish a viable housing market.

The heads of the two major regulators, John Dugan at the OCC and Ben Bernanke at the Federal Reserve were instrumental in allowing and in facilitating this foreclosure crisis. They continue to refuse to address it from a regulatory approach. While the banks were required to accept TARP funds to address the safety and soundness of the financial industry, they refuse to use that same Safety and Soundness standard to assist the millions of homeowners at risk of foreclosure. John Dugan needs to take the first step and utilize his regulatory power and require Chase and the other institutions the OCC regulates to provide affordable solutions. Chairman Ben Bernanke, who has been silent on this, needs to do the same. In no uncertain terms, federal regulators must push Servicers to permanently modify unaffordable mortgages. If this does not occur we will have massive foreclosures ahead of us. It is unthinkable for the U.S. Treasury to have to bribe, beg and plead with Servicers to modify loans. When and how did our government become so powerless? Why aren't Servicers penalized for violating Treasury terms they agreed to? Dramatic action must be taken by the Obama Administration.

There must also be legislation enacting bankruptcy reform which would put the Servicers on notice. Bankruptcy court judges should be able to change the terms of primary mortgage loans when a modification is appropriate. Finally, the future lending environment needs to be changed which requires enactment of a Federal Consumer Agency to protect homeowners from predatory loans. No new restrictions exist today to prevent lenders from repeating the same disastrous practices.

Thank you for the opportunity to speak before the Financial Services Committee today. I welcome the opportunity to answer any questions.

---

[1] Floyd Norris, Why Many Home Loan Modifications Fail, New York Times (Dec. 3, 2009).

[2] Diane E.Thompson, *Why Servicers Foreclose When They Should Modify and Other Puzzles of Servicer Behavior, Servicer Compensation and its Consequences,* National Consumer Law Center (OCT. 2009).

[3] Gretchen Morgenson, Why Treasury Needs a Plan B for Mortgages, New York Times (Dec. 5, 2009).

For Release Upon Delivery
9:30 a.m., December 8, 2009

TESTIMONY OF

DOUGLAS W. ROEDER

SENIOR DEPUTY COMPTROLLER FOR LARGE BANK SUPERVISION

OFFICE OF THE COMPTROLLER OF THE CURRENCY

Before the

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

December 8, 2009

Statement Required by 12 U.S.C. § 250:
The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

INTRODUCTION

Chairman Frank, Ranking Member Bachus, and members of the Committee, on behalf of the Comptroller of the Currency, I appreciate the opportunity to discuss the state of national banks' residential mortgage modification efforts.

As has been widely described, current economic conditions continue to have a significant adverse affect on the mortgage market, on homeowners' abilities to meet their mortgage obligations, and on banks' abilities to effectively meet that challenge. High unemployment levels and depreciated home values have constrained many of the options available to financially pressed borrowers and their lenders. While banking regulators cannot solve these underlying structural issues confronting our economy, we do supervise banks with respect to their obligations to prudently meet the credit needs of their local communities and deal with their customers in a fair manner. In this regard, we can and are taking actions to ensure that national banks are working constructively with borrowers who are facing difficulties with their mortgages. The Office of the Comptroller of the Currency (OCC) has directed national banks to make their homeowner assistance programs more sustainable and to improve the quality of available information about the performance of national bank mortgage portfolios, programs to assist troubled homeowners, and trends in foreclosures. Given the problems servicers face with having sufficient operational and staffing capacity to handle the volume of modification requests, we also have directed national banks to implement action plans to address deficiencies in these areas.

As I discuss in my testimony, the pace and effectiveness of home retention efforts undertaken by national banks has improved in recent quarters. While much of the national focus has been on actions made under the "Home Affordable Modification Program" (HAMP),

mortgage servicers also assist borrowers through other loan modification and payment plan programs.[1] National banks and federally regulated thrifts act as servicers with respect to approximately two-thirds of all residential mortgages in the United States, some of which they hold on their balance sheets, but most of which are held by third party investors in securitized mortgage pools. The largest national bank and thrift servicers are covered by the quarterly "Mortgage Metrics" reports issued jointly by the OCC and Office of Thrift Supervision (OTS). As reported in that report, these large national banks and thrifts implemented more than 1.8 million loan modifications and payment plans between January 1, 2008 and June 30, 2009, including 114,538 actions taken under HAMP.[2] None of the modifications or payment plans made outside of HAMP receive taxpayer-supported payments or incentives.

Despite the progress that has been made in national banks' loan modification efforts, the economic environment continues to pose considerable challenges to homeowners' and banks' home retention efforts. In many cases, these conditions result in borrowers who are unable or, less frequently, unwilling to comply with program documentation requirements or meet modified loan terms. The reality is that the various homeowner assistance programs underway will help many but not all homeowners.

My testimony today focuses on five areas: 1) the evolution of homeowner assistance programs; 2) the volume and type of loan modifications among large national bank and thrift servicers as reported in our quarterly Mortgage Metric Reports; 3) the performance of loan modifications to date; 4) our supervisory assessments of residential mortgage modifications; and 5) the call for additional regulatory initiatives.

---

[1] Loan modifications are permanent changes to one or more terms of a mortgage contract. Payment plans are typically short-term agreements to return a mortgage to current and performing status or a period of trial payments prior to a permanent loan modification.

[2] See the *OCC and OTS Mortgage Metrics Report for the Third Quarter 2008* (http://www.occ.gov/ftp/release/2008-150a.pdf).

THE EVOLUTION OF HOMEOWNER ASSISTANCE PROGRAMS

Previous to this economic cycle, borrowers with financial difficulties typically worked through their problems by refinancing or selling their homes, and the demand for loss mitigation through loan modifications or payment plans was fairly low. When offered, loss mitigation was generally limited to borrowers who experienced a temporary disruption in income due to significant life events—divorce, serious illness, or temporary job loss. These traditional loan modifications were designed to give responsible borrowers an opportunity to weather a temporary disruption in income until they could resume regular monthly mortgage payments. The vast majority of these programs capitalized missed payments, interest and fees, and re-amortized the balance across the remaining term of the loan.

As the economy deteriorated in 2007 and home prices fell, borrowers could no longer turn to refinance or sale options in most markets as ways to repay their mortgages. These conditions led to a sharp increase in delinquencies and foreclosures as well as the recognition by federal regulators and others that loan modification programs on a much larger scale would be needed. The full extent of the problem only became apparent over time, and banks efforts to meet those challenges faced difficulties. Those difficulties included the following:

- First, traditional loss mitigation programs were labor intensive, conducted loan by loan. Servicers did not have in place sufficient resources to address a high volume of troubled borrowers seeking loan modifications.
- Second, servicers initially had difficulty contacting customers who were at risk and could be assisted through loss mitigation efforts. Servicers reported that the response rate to offers or queries was extremely low.

- Third, servicers faced contractual and potential legal limitations to modifying loans on the scale needed to adequately respond to increasing delinquencies and foreclosures. Pooling and servicing agreements constrained the volume and type of modifications that servicers could offer to borrowers.

As the foreclosure crisis expanded, national banks, at our direction, ramped up the scale of their loan modification programs. The volume of loan modifications increased, but many borrowers were still unable to make sustained payments on their loans, even with the modifications. Loan modifications and payment plans made in late 2007 and early 2008 often followed the traditional approaches of capitalizing and re-amortizing past due interest and fees, resulting in increased monthly payments. While this strategy was effective when more favorable economic conditions existed and home values were rising, it was not effective in more adverse economic conditions in addressing the record number of borrowers who were falling behind on their mortgage payments. Reflecting these shortcomings, our quarterly Mortgage Metrics Report documented a high number of re-defaults in the loan modifications made in the first and second quarters of 2008. After six months, nearly 54 percent of the loan modifications made by national banks and federally regulated thrifts in the first quarter of 2008 were 30 or more days past due and nearly 37 percent were more than 60 days past due.

On March 4, 2009, the Department of the Treasury announced HAMP.[3] This program became the primary national focus of homeowner assistance with consumer, investor, and servicer incentives intended to provide sustainable loan modifications to prevent avoidable foreclosures. At about this same time, the OCC issued supervisory letters to all of the major servicers participating in the Mortgage Metrics reporting initiative, directing them to identify and

[3] See "Relief for Responsible Homeowners One Step Closer Under New Treasury Guidelines," March 4, 2009. (http://www.makinghomeaffordable.com/pr_030409.html)

restructure modifications made during 2008 that did not result in sustainable performance, and assess loan modification policies and procedures to ensure sustainable modifications that would be more effective in keeping borrowers in their homes. The OCC was able to take this specific supervisory action because of the increased information regarding loan modification performance made possible through our Mortgage Metrics initiative. At the OCC, we also stepped up our monitoring and onsite examination of large bank mortgage default management functions. Since those actions, we have seen significantly more modifications that reduce monthly principal and interest payments and better performance from more recent modifications.

In advance of the Administration's program, in response to our directives, and the increased public visibility created by our quarterly Mortgage Metrics Report, servicers increased their focus on the combination of modified loan terms that improved the likelihood of payment sustainability. Mortgage Metrics data released in April 2009 showed loan modifications that reduced monthly payments by more than 10 percent experienced half the serious delinquencies after modification when compared with loan modifications that increased payments or left payments the same.[4] This early data supports a key objective of the Administration's program, which is designed to lower monthly payments as a means of making the modification more sustainable.

Under HAMP, borrowers are required to submit financial documentation to demonstrate repayment ability and to successfully complete a three-month trial period before their loan is permanently modified. While significant volumes of HAMP trial period plans began during the summer and fall of 2009, conversion to permanent modifications has been slow. Part of this has been due to servicers having insufficient staff and systems to process the increasing number of

---

[4] See *OCC and OTS Release Mortgage Metrics Report for Fourth Quarter 2008*, April 3, 2009. (http://www.occ.gov/ftp/release/2009-37a.pdf)

HAMP trial period plans. Because of these problems, OCC examinations at all of the large national bank mortgage servicers have focused on the adequacy of staffing and operating systems. Where we find shortcomings, we are requiring bank management to implement plans to remedy those shortcomings.

We must also recognize, however, that many servicers, in an effort to increase the number of HAMP actions, initiated trial period plans based on oral representations from the borrower. Servicers are now experiencing difficulty in obtaining and processing the necessary documentation required by the program to verify income and other financial information, and in validating the information when it is provided. Once the required documentation is received, servicers report that a significant number of these borrowers do not qualify under the current guidelines of HAMP. In some cases, the loan is already considered affordable to the borrower under the 31 percent debt-to-income guideline. In others, the borrower cannot demonstrate a valid financial hardship or is not at risk of imminent default. Increasingly, however, the inability to qualify under HAMP reflects borrowers whose financial conditions have deteriorated to the extent that it is not possible to structure an effective modification that meets the net present value requirement of the program.

To promote conversion to permanent modifications, the Department of the Treasury announced an initiative on November 30, 2009, to help convert trial period plans to permanent modifications.[5] The program provides additional information and assistance to homeowners to help them complete their obligations; it also intends to create greater accountability for servicers' performance in the program.

---

[5] See "Obama Administration Kicks Off Mortgage Modification Conversion Drive," November 30, 2009. (http://www.makinghomeaffordable.com/pr_11302009.html)

In addition to HAMP, national banks continue to help troubled homeowners avoid foreclosure through their own loan modification programs. Servicers generally consider HAMP actions as only one, albeit an important, tool in their loss mitigation "toolbox" and often will offer proprietary modification to many borrowers who do not qualify under HAMP. We have emphasized to national banks that such programs should be designed to achieve both affordability and payment sustainability, and our data shows that more than three quarters of the modifications implemented during the second quarter of 2009 have reduced the borrowers' monthly principal and interest payments. Predictably, the performance of these modified loans improves as payments are reduced.

The various home retention alternatives used today, including HAMP and similar programs offered by servicers—especially those that appropriately reduce monthly payments—continue to hold the promise of producing sustainable modifications. They offer eligible borrowers an affordable payment and a chance to keep their homes, but success often requires borrowers to make significant debt and lifestyle changes. While many borrowers can and will be helped through these various programs, it is also important to acknowledge that there will be many who cannot.

THE VOLUME AND TYPE OF LOAN MODIFICATIONS AMONG NATIONAL BANKS AND FEDERALLY REGULATED THRIFTS

As previously noted, our most recent publicly released data on the volumes and types of loan modifications through the second quarter of 2009 showed a significant increase in volume and a continuing shift toward loan modifications that reduced monthly principal and interest

payments. The *OCC and OTS Mortgage Metrics Report for the Second Quarter 2009*[6] continued to show the negative effects that high unemployment and depressed home values are having in the housing markets as the number of seriously delinquent mortgages and foreclosures in process continued to increase. Against this backdrop, however, home retention actions—including loan modifications and payment plans—rose 21.7 percent from first quarter 2009 to 439,574, nearly 75 percent more than were implemented a year earlier. We expect a further increase in the third quarter.

During the last two quarters, emphasis on HAMP contributed to a dramatic shift in the composition of home retention actions toward payment plans. Because actions taken under the program begin with a three-month trial period, they are reported as payment plans rather than loan modifications. As a result, servicers reported a 73.9 percent increase in payment plans, and a 25.2 percent drop in loan modifications. The 114,538 HAMP trial period payment plans reported in the second quarter more than offset a 47,995 decrease in loan modifications as servicers reallocated resources to HAMP.

Because HAMP did not become operational until May 2009, significant volumes of actions under this plan did not begin to occur until the third quarter of 2009. HAMP, however, represents only part of national banks' ongoing efforts to work with mortgage borrowers. The national bank and thrift servicers covered by our Mortgage Metrics Report implemented more than 1.8 million loan modifications and payment plans between January 1, 2008 and June 30, 2009, of which 114,538 were made under HAMP (see Table 1). Importantly, these institutions also have been originating and refinancing many new, lower-rate mortgages, including a

---

[6] See *OCC and OTS Mortgage Metrics Report for Second Quarter 2009* (http://www.occ.gov/ftp/release/2009-118a.pdf)

significant volume of FHA-guaranteed loans to low- and moderate-income borrowers who have had insufficient funds for a large down payment.

Table 1. **Number of Home Retention Actions—New Loan Modifications and Payment Plans**

	6/30/08	9/30/08	12/31/08	3/31/09	6/30/09	1Q %Change	1Y %Change
Loan Modifications	**125,348**	**114,070**	**116,354**	**190,357**	**142,362**	**-25.2%**	**13.6%**
"Making Home Affordable Trial Period Plans	--	--	--	--	114,538	--	--
Other Trial Period Plans	--	--	--	51,189	59,571	16.4%	--
Other Payment Plans	126,114	154,649	177,314	119,756	123,103	2.8%	-2.4%
Total Payment Plans	**126,114**	**154,649**	**177,314**	**170,945**	**297,212**	**73.9%**	**135.7%**
Total	**251,462**	**268,719**	**293,668**	**361,302**	**439,574**	**21.7%**	**74.8%**

As shown in Table 1, the number of home retention actions, which combines both loan modifications and payment plans, has steadily increased over the past year. We anticipate seeing additional increases in the third quarter when we release our next Mortgage Metrics Report later this month.

To achieve modifications with more affordable payments, servicers are increasingly changing more than one term in a borrower's mortgage contract. Indeed, three quarters of all modifications implemented during the second quarter of 2009 changed more than one loan term. The most common modification actions to date have been the capitalization of missed fees and payments accompanied with reduction of the interest rate and term extensions. While still a small fraction of all loan modifications, the percentage of modifications that reduced principal more than tripled to 10 percent of modifications made in the second quarter compared with 3.1 percent in the first quarter.

As shown in Table 2, more than 78 percent of all modifications implemented during the second quarter of 2009 reduced monthly payments, up from fewer than 54 percent in the previous quarter. This trend, which we expect to continue in the third quarter, represents a

significant shift from earlier practices, in which the vast majority of loan modifications either did not change or increased monthly payments.

Table 2. **Change in Monthly Principal and Interest Payments Owing to Modification** (Percentage of Modifications)

	6/30/08	9/30/08	12/31/08	3/31/09	6/30/09	1Q %Change	1Y %Change
Decreased by 20% or More	18.1%	18.0%	26.1%	28.8%	38.6%	34.4%	113.2%
Decreased by 10% to Less than 20%	10.6%	12.3%	13.1%	12.2%	19.7%	62.2%	85.9%
Decreased Less than 10%	12.2%	12.4%	13.6%	12.6%	19.9%	57.8%	62.9%
Subtotal for Decreased	**40.9%**	**42.7%**	**52.8%**	**53.5%**	**78.2%**	**46.2%**	**91.1%**
Unchanged	26.4%	24.8%	22.4%	28.4%	4.3%	-84.8%	-83.6%
Increased	32.7%	32.6%	24.8%	18.1%	17.4%	-3.5%	-46.6%
Subtotal for Unchanged and Increased	**59.1%**	**57.3%**	**47.2%**	**46.5%**	**21.8%**	**-53.2%**	**-63.2%**
Total	100.0%	100.0%	100.0%	100.0%	100.0%	--	--

One important measure of the effort to assist responsible homeowners is the number of new home retention actions compared with the number of new foreclosures. In the second quarter of 2009, home retention actions—loan modifications and payment plans—continued to increase more quickly than new foreclosures. Subprime mortgages had almost twice as many new home retention actions as new foreclosures during the quarter. Early analysis of third quarter data suggests that this trend will also continue.

As noted at the outset of my testimony, the OCC has directed bankers to focus on improving the sustainability of homeowner assistance programs. Improving sustainability and returning borrowers to a positive cash flow ultimately reduces the number of eventual foreclosures, provides homeowners a means of holding on to their homes for the long term, and minimizes losses to banks and investors.

THE PERFORMANCE OF LOAN MODIFICATIONS TO DATE

An increasing volume of home retention actions and an increasing proportion of those modifications that significantly reduce monthly principal and interest payments resulted in improvements in the sustainability of more recent loan modifications.

Overall, the percentage of modified loans that were 60 or more days delinquent or in the process of foreclosure rose steadily in the months subsequent to modification for all quarterly vintages within our report. However, early indications are that more recent vintages of modifications, in particular those implemented in fourth quarter 2008 and first quarter 2009, are performing better than previous vintages and may be more sustainable over time.[7] We will continue to monitor these modifications to determine whether they will perform significantly better in the long run.

Table 3. **Modified Loans 60 or More Days Delinquent**
(60+ Re-Default Rate for 2008–2009 Modifications)

Modification Date	Three Months after Modification	Six Months after Modification	Nine Months after Modification	12 Months after Modification*
First Quarter 2008	22.8%	37.0%	46.6%	54.0%
Second Quarter	27.9%	44.1%	52.1%	56.2%
Third Quarter	30.8%	46.2%	53.5%	--
Fourth Quarter	28.1%	40.8%	--	--
First Quarter 2009	27.7%	--	--	--

When we look more specifically at the performance of loan modification by change in monthly principal and interest payments, we see significant differentiation in the performance of those loan modifications.

Modifications that decreased monthly payments had consistently lower re-default rates, and loans with greater percentage decreases in payments exhibit lower subsequent re-default rates. While lower payments reduce monthly cash flows to mortgage investors, they also appear

[7] Data include only modifications that have had time to age the indicated number of months.

to improve longer term sustainability of the mortgage payments. After 12 months, about 34 percent of modifications that decreased monthly payments by 20 percent or more were 60 or more days past due. In contrast, about 63 percent of modifications that left payments unchanged and nearly 65 percent of modifications that increased payments were 60 or more days past due after 12 months (see Table 4).

Table 4. **Re-Default Rates of Loans Modified in 2008-2009 by Changes in Payment** (60 or More Days Delinquent)*

	Three Months after Modification	Six Months after Modification	Nine Months after Modification	12 Months after Modification
Decreased by 20% or More	15.0%	24.6%	30.4%	34.1%
Decreased by 10% to Less than 20%	16.7%	29.3%	36.9%	43.0%
Decreased by Less than 10%	18.8%	36.1%	45.4%	50.8%
Unchanged	47.2%	57.0%	62.8%	63.4%
Increased	30.3%	50.9%	60.6%	64.7%

*Data include only loans implemented since first quarter 2008 that had time to age the indicated number of months as of June 30, 2009. For example, only modifications implemented during first and second quarter 2008 have been in effect at least 12 months subsequent to the modification.

We will continue to track and report the performance of these modifications as we go forward.

SUPERVISORY ASSESSMENTS OF RESIDENTIAL MORTGAGE MODIFICATIONS

While there has been progress in expanding homeowner assistance programs, there are still very significant challenges ahead for homeowners, the housing market, banks, and investors who have significant exposure to residential mortgages. These challenges include continued fallout from weak economic and residential real estate market conditions, ongoing mortgage performance issues resulting from consumer over-leverage and unemployment, and restoration of investor confidence and a functioning secondary market.

The financial system and markets are more stable than in the fall of 2008, but weak asset quality continues to be a significant concern across most loan portfolio segments, including

residential mortgage portfolios. At the end of the second quarter of 2009, of the 34 million loans evaluated in our quarterly Mortgage Metrics Report, the percentage of current and performing loans had fallen for the sixth consecutive quarter to less than 89 percent. The percentage of seriously delinquent loans—loans 60 or more days past due and mortgages to delinquent bankrupt borrowers—reached 5.3 percent of the total portfolio, or nearly 1.8 million loans. The number of foreclosures in process increased to 2.9 percent or just less than 1 million loans. We expect the trend of increasing delinquencies to continue as homeowners feel the effects of high unemployment and depressed home prices. While loan modifications will help a percentage of responsible homeowners struggling to make payments to stay in their homes, sustained high unemployment and home values that are underwater will limit the percentage of homeowners that loan modifications will be able to help. As a result, foreclosures will remain high even as the economy begins to recover.

The OCC fully supports servicer participation in HAMP and the Administration's Second Lien Modification program. On Monday, we issued guidance to our examiners restating our support for these programs and further clarifying how examiners should review loan modification programs and the related accounting for Troubled Debt Restructurings (TDRs). The guidelines are applicable to both government and proprietary modification programs, and do not replace or supersede generally accepted accounting principles (GAAP) or other existing supervisory guidance. The guidance also stresses that participation in government or proprietary modification programs does not relieve banks of their fiduciary responsibilities to ensure that their regulatory reports and financial statements are accurate and fairly represent the financial condition of the bank and its assets. In this regard, we expect banks to follow GAAP and maintain adequate allowance for loan and lease losses (ALLL) regardless of whether a loan is

modified. This includes recognition of loan modifications as TDRs with appropriate reserves and/or charge-off recognition when necessary. Key factors, such as demonstrating a borrower's ability and willingness to repay debt, should not be sacrificed for the expediency of making a loan modification or to increase the number of reported payment plans and modifications. In the long run, relaxing basic prudential standards with regard to documenting proof of income and key underwriting factors will only lower the success of programs designed to help homeowners and minimize loss.

As might be expected given the significant increase in troubled borrowers and the challenges in implementing effective loan modifications and other loss mitigation strategies, the number of complaints related to home lending and loan modifications made to our Customer Assistance Group has increased in the last two quarters. We take these complaints very seriously, and promptly obtain and forward the necessary information to the banks and, when appropriate, our onsite examiners to ensure appropriate resolution. As part of our ongoing supervision at national banks, our examiners assess management's complaint resolution process and require corrective action for identified deficiencies.

CALL FOR ADDITIONAL REGULATORY INITIATIVES

The need for prudent, well structured and sustainable loan modifications continues. However, we would be remiss if we did not examine the causes of the current crisis to make needed changes to avoid repeating these terrible problems in the future. In this regard, Comptroller Dugan recently urged financial regulators both here and abroad to establish minimum underwriting standards for all mortgages made in their respective countries. Chief among these standards in the United States are required financial documentation to evaluate and

verify the borrower's payment ability; meaningful down payments to ensure the borrower has "skin in the game"; and qualification of borrowers for mortgages based on the fully indexed rate and payment that the loan structure will require, rather than on an introductory or temporary minimum payment that is typically much lower. We believe that such national standards would significantly improve the confidence in housing markets and help prevent a recurrence of the housing risks we saw over the past few years. In this regard, it will be critical to implement and enforce such standards uniformly across all lenders, ensuring that the far more lax standards of unregulated mortgage originators are raised to the same level as regulated banks and thrifts.

CONCLUSION

Although there are positive signs in many parts of the economy, the residential mortgage market continues to struggle with the effects of high unemployment, low home prices, and highly leveraged borrowers. We have directed national banks to improve operational efficiency to keep up with volume, improve the management of their internal processes, and answer their customers' concerns accurately and promptly.

There has been progress in the industry's loan modification efforts. But, I am realistic about the fact that we will see further deterioration in loans serviced by banks in the months ahead as unemployment remains high and home prices remain low. In these economic conditions, homeowner assistance will help many but not all homeowners.

Finally, I think it is useful to remember that the vast majority of national banks are strong and have the capacity to weather difficulties related to residential lending, and that the vast majority of borrowers are performing on their loan obligations. The OCC will continue to work

through the difficult issues related to residential lending in cooperation with the Administration and other financial regulators.

Testimony of Anthony B. Sanders
Committee on Financial Services
U.S. House of Representatives
Washington, D.C.
December 8, 2009

Mr. Chairman and Members of the Committee:

Thank you for the invitation to testify before you today.

There are a variety of Federal government programs and initiatives for attempting to create more sustainable mortgage payments for borrowers in imminent risk of default on their home loans. I will focus my attention on the Obama Administration's "Making Home Affordable Program."

According to the "Making Home Affordable Program Servicer Performance Report Through October 2009," 920,000 trial modification plans have been offered to borrowers and there have been 651,000 trial modifications made. Given the "fall off the cliff" of housing prices in many states, the surge of unemployment and the evaporation of liquidity for banks and related institutions in the second half of 2007, I am frankly surprised that the servicing industry has moved so quickly to make loan modifications in such large numbers. This is especially true when one considers how the very nature of the residential servicing industry has changed since 2007 in terms of number of problem loans to be serviced so dramatically. With 14.4 percent of borrowers in foreclosure or delinquent on their mortgages (as of September), this creates an incredible challenge to the servicing industry.

It is a real challenge to servicers to make loan modifications succeed when 70 percent of modifications that have only interest rate cuts have gone into re-default after 12 months. If the loan modification affordability calculation, as done under HAMP, only uses the first lien position, taxes and insurance and fails to include home equity loans, car leases, credit card debt and other debt burdens, the failure of loan modifications is not unanticipated. And, as I mentioned in the House TARP hearings during November 2008, the negative equity problem in the "sand states" of California, Arizona, Nevada and Florida is going to be very, very challenging for the servicing industry; loan modifications must take into consideration the negative equity position of households to determine their likelihood of success for making mortgage payments.

But even if servicers continue with this incredible growth rate in trial loan modifications, it is unclear how many trial modifications will become permanent modifications. The most likely "conversion" rate of trial to permanent modifications is about 33%, although it could be even lower. And the re-default rate on those trial loans that survive the challenge of making three consecutive mortgage payments during the trial period will likely be about 50-60% or even higher.[1] Say that only 25% of borrowers

[1] Lender Processing Services in late May 2009 reported that nationwide modification efforts as of April achieved a re-default rate of nearly 50% six months after modification (with the Office of the Comptroller of the Currency showing a 55% re-default rate within six months).

convert from trial to permanent modifications and then 50% of those go into re-default, that translates into 12.5 of eligible borrowers actually receiving permanent loan modifications and keeping them current. And it is entirely possible that the "success" rate could even fall below 10% of eligible loans.

Why are so few loans expected to be permanent?

There are several reasons why so few loan will make the transition from temporary modification to successful permanent modification.

The first reason for the projected failure rate is the degree to which many residential loans in the United States are in a negative equity situation. According to a Deutsche Bank research report, they are expecting 25 million homes to be in negative equity position.[2] Although negative equity in small amounts is not a problem, larger negative equity positions such as 125-150% LTV are difficult to modify (even if the HAMP allowed such large modifications). Therefore, permanent loan modifications in areas with large house price declines will be extremely difficult.

The second reason for the poor prediction for successful permanent loan modifications is the unemployment rate. While 10% report unemployment rate is bad enough, the true unemployment rate (including wage and salary curtailment) is closer to 17.5%. This is a very challenging obstacle to overcome for the servicing industry. When you combine high unemployment rates with a severe negative equity problem, this "perfect storm" of bad conditions places enormous burdens on the servicing industry.

The third reason for poor transition figures is documentation problem. To qualify for a trial loan modification, the HAMP program is following the stated income approach that does not require documentation. Like stated income loans, stated income qualification for temporary loan modification is a fertile ground for moral hazard problems where borrowers/applicants that are insulated from risk may behave differently from the way it would behave if it would be fully exposed to the risk. In this case, borrowers may not want to submit the required documentation since they may be denied for a permanent modification. While there have been stories of servicers making it "difficult" for borrowers to submit the necessary documentation, one has to consider the flip side of the argument. Borrowers may claim that the servicers are making it difficult to obtain documentation when, in fact, they may just simply be hoping that the permanent modification will be approved without full documentation. In fact, a recent article in the New York Times discusses how willing the servicers were to make loan modifications, only to find that borrowers were not completing the submission of the required paperwork.[3] This is not to say that some borrowers have not experienced "true" documentation problems, which would be consistent with the dramatic growth in demand for loan modifications through HAMP as servicing entities ramp-up their servicing efforts to meet the demand.

---

[2] http://www.bloomberg.com/apps/news?pid=20603037&sid=adBYDzUMt68k
[3] http://www.nytimes.com/2009/12/04/business/economy/04norris.html

The fourth reason, also discussed in the aforementioned New York Times article, is that many borrowers are having trouble making their three consecutive mortgage payments during the trial modification period. In addition, borrowers may not qualify for the temporary modification by having 1) too much income, 2) not enough income, or 3) have a house that has fallen too much in value.

Servicer performance and the Servicer Performance Report

The Making Home Affordable Program provides a "Servicer Performance Report" that rank orders servicers in terms of "Active Trial Modifications as a Share of Estimated Eligible 60+ Day Delinquencies." The higher the ranking, the more active trial modifications the servicer is making.

The problem with this accounting method for "success" is that it does not control for servicers with loans in particularly hard hit areas such as "bubble" states like California, Arizona, Nevada and Florida. Servicers in states where house prices have collapsed, sometimes by as much as over 50%, are going to be heavily challenged to perform these loan modifications. When you add in the already high unemployment rate in these states, these are indeed challenging areas to perform loan modifications.

In addition, the highest unemployment rates by metropolitan area (as of September 2009) are Detroit (18.5%), Warren MI – suburb of Detroit (17.0%), Riverside CA (14.1%), Las Vegas NV (13.7%) and Los Angeles CA (12.7%). While Arizona has "only" a 9.1% unemployment rate, the difficulty of loan modifications must be considered when combined with the crash of housing prices that occurred there.[4] The states and metropolitan areas with the highest unemployment rates should be taken into consideration by Treasury when determining loan modification trial success rates.

My recommendation for reporting servicer performance is to adjust the service performance by percentage of loans in 1) bubble states and 2) Midwest "economic malaise" states such as Ohio and Michigan. In short, modifying loans in Nebraska is likely to be far easier than modifying loans in Arizona, Nevada or the Inland Empire of California. Therefore, servicers should be given additional credit for attempting to modify loans in these challenging areas.

Why is there a low level of principal write-downs for underwater mortgages?

When financial institutions and other holders of mortgages (investors) accept loan modifications, short sales and short payoffs, they take an immediate hit, causing them to reduce earnings and receive pressure from regulators to raise additional capital. To provide an incentive for financial institutions/investors to sell their distressed mortgage loans to the private markets, the government regulators, including the SEC, should allow financial institutions/investors to amortize the losses for up to 5 years to spread the accounting consequence of a loss over time. This would enable the financial institutions/investors to sell distressed assets from their books and free up funds to be invested elsewhere such as loans to small businesses. While programs like HAMP are meant to keep people in their houses, we need to provide an incentive to financial institution to avoid becoming "zombie banks"

[4] Anthony B. Sanders, "The Subprime Crisis and its Role in the Financial Crisis," *Journal of Housing Economics*, Volume 17, Issue 4, December 2008.

as has occurred in Japan. While the HAMP program might keep some people in their homes, the program maintains the loan with the lender and does not free funds for uses other than housing until the loan is paid off or refinanced. And with some of the 40-year extension of loan life for some of the modifications, this would mean that these loans would be on the balance sheets of the lenders/investors for almost a half century.

Once the financial institutions/investors can dispose of distressed loans from their portfolios, private market groups can acquire these loans and enact private market loan modifications.[5] In fact, allowing financial institutions/investors to sell their distressed assets without immediate devastating consequences would enable them to pursue loan modifications through their services more aggressively, if economically appropriate.

Another advantage of allowing financial institutions/investors to sell the assets without immediate adverse consequences is that is opens the door for more broad approaches to dealing with the foreclosure crisis such as 1) short payoffs, 2) short sales, 3) foreclosure, 4) conversion to leases and 5) broader loan modifications if they make economic sense. Particularly given the vacancy rates in many states in the housing market, conversion to leases makes sense given the comparatively low rental rates compared to mortgage payments. Private funds has offered interesting loan modification examples as converting the loan to a rental agreement with an option for the former borrower to purchase the house, a shared appreciation approach where the borrower shares part of the upside with the lender in return for a principal write-down on the loan.

Accounting changes to permit financial institutions/investors to remove their distressed assets from their books clearly dominate alternatives such as "cramdowns" or other judicial interventions into the mortgage market. Helping financial institutions/investors dispose of their distressed assets was one of the original purposes of TARP and we should now consider the wisdom of cleaning-up financial institution balance sheets rather than judicial interventions.

I welcome any questions and appreciate the opportunity to speak with you.

[5] For example, Selene Residential Mortgage Opportunity Fund ("SRMOF") is a private fund that can purchase, service and restructure loans.

TESTIMONY OF

JACK SCHAKETT

CREDIT LOSS MITIGATION STRATEGIES EXECUTIVE

BANK OF AMERICA HOME LOANS

Before the

HOUSE FINANCIAL SERVICES COMMITTEE

WASHINGTON, DC

DECEMBER 8, 2009

Chairman Frank, Ranking Member Bachus, and Members of the Committee, thank you for the opportunity to update you on Bank of America's loan modification efforts and to discuss areas where we can work together to help more borrowers stay in their homes.

I am Jack Schakett, Bank of America's Credit Loss Mitigation Strategies Executive. I report to Bank of America Home Loans President, Barbara Desoer, and have responsibility for foreclosure prevention programs for a mortgage servicing portfolio of nearly 14 million loans.

Bank of America Making Home Affordable Performance

Bank of America is proud to be a partner in the Administration's Making Home Affordable program. Under the Home Affordable Refinance Program (HARP), Bank of America is the industry leader – providing refinancing through this process to more than 100,000 customers. And leveraging the Home Affordable Modification Program (HAMP), we now have more than 160,000 customers enrolled in a trial modification – leading the industry, as of October, in the number of active trials and offers extended. This record demonstrates our strong commitment to the program's success and to Treasury's leadership.

HAMP is the first loan modification solution we consider for borrowers who meet the initial eligibility requirements for the program. HAMP has proven a valuable tool that complements the aggressive loan modification programs we already had in place. Over the last two years, our own loan modification efforts have helped an additional 450,000 Bank of America customers. Combined with the HAMP program, these efforts have helped nearly 615,000 homeowners.

Importantly, Bank of America is not proceeding with foreclosure sales for customers who may be eligible for a modification under HAMP or our other modification programs and with whom we have been able to establish contact. Those holds remain in place during the time that it takes us to evaluate the borrower and through the trial modification period.

None of this is to say that there have not been problems. In over 100,000 calls a day, we hear from customers - their concerns and frustrations. We believe we have improved significantly our ability to handle the large volumes associated with these programs and are focused on constant enhancements. These are difficult times for customers and our intent is to make this as easy and understandable for them as we can.

As the largest servicer in America, we applaud the U.S. Treasury's continued efforts to ensure the success of these important programs and their determination to work as partners to achieve our common goal of keeping people in their homes.

Today, I'd like to discuss with the Committee two areas where we have gaps to close, and where we have the opportunity to make adjustments that will enable servicers to assist even more distressed homeowners.

First, a status report on the conversion of trial modifications to permanent. And second, a discussion of our HAMP progress overall and recommended enhancements to the program to help more borrowers.

Trial to Permanent Modification Conversion Status and Challenges

On Monday, December 7, Bank of America participated in the Servicer CEO Summit hosted by U.S. Treasury Secretary Timothy Geithner. We fully share Treasury's commitment to convert successful trial modifications to permanent as quickly as possible.

In support of that commitment, Bank of America is focusing on assisting customers to collect and provide all the documents and information required for the underwriting necessary for a successful conversion. Otherwise, homeowners are at risk of missing this opportunity to obtain a HAMP loan modification, an outcome none of us want.

As this committee knows from prior hearings, in addition to customers making three timely trial payments, the servicer must fully underwrite the permanent modification by obtaining all required documentation. This includes verifying income, occupancy status, and tax returns. The single biggest obstacle to a quick and successful conversion is obtaining the required financial information to underwrite the permanent modification. When borrowers originally entered their trial modifications they were not required to provide all the documents necessary for approval of a permanent modification. They were told that in order to qualify for a permanent modification they must provide all such documents during the trial period.

Bank of America has approximately 65,000 customers who have made more than three trial modification payments on time and their modifications are set to expire on December 31, 2009. Unfortunately, of those customers, 50,000 have either not submitted some or all of the required documents or have submitted all their required documents, but the documents reveal discrepancies that require an additional response from the customer. It is unclear why this has happened to such a high degree; however, several factors likely contributed to this, including ineffective communications with customers, shortcomings in document maintenance, misunderstandings about program requirements, and the inability to comply by some borrowers.

Our focus now is to make sure that every customer who has successfully made three or more trial modifications payments understands their document obligations and has an effective method for completing all the necessary requirements.

For these customers, Bank of America last week sent by express mail an urgent request for the documents needed to complete the process and the time frame required to avoid losing the Treasury's modification program benefits. We included a return prepaid express mail envelope to make the process as easy and expeditious as possible. We choose written communication and express mail packages to reduce the risk of misunderstanding, lost faxes or other issues associated with document collection, a part of the process that has been a source of customer frustration and where we have worked hard to improve.

While we manage extraordinary volume, we are doing everything we can to ensure optimal efficiency of all document control and management. Bank of America launched fax-to-image technology employed solely for the HAMP program. Once we obtain the documentation, we have the necessary staffing to complete the review and process the permanent conversion, and we will continue to add capacity as needed.

We will repeat the express mail notification again next week for any customers who still lack completed documentation and are also looking at ways we can partner with housing counselors to work face-to-face with customers to help them through the document submission process.

For the 15,000 customers who have provided all required information, we are experiencing a high conversion rate, with denials predominantly resulting from either income differences from what was stated by the borrower at the time of trial modification or discovery that the property is no longer owner-occupied, a requirement of the program.

We applaud the announcement by Treasury last week to partner with servicers to help heighten awareness of the need to promptly follow through with submitting documentation and to make it a priority to meet with the notary to sign the final loan modification agreement.

Consistent with these efforts, Bank of America is maintaining the same sense of urgency. By the time our trial modification participants reach their HAMP expiration date, Bank of America will have made about ten reminder phone calls and sent – at least twice – a summary of required documents and a postage-paid express mail package through which they can return their documents. This is in addition to the original trial modification mailing we send customers when they enter the program.

We have dedicated substantial resources to these efforts including the expansion of our default management staffing to nearly 13,000. We have also employed representatives of Bank of America in key markets to attempt face-to-face outreach to customers who have failed to send in required documents, and we have moved hundreds of mortgage loan officers over to servicing to assist in helping customers convert to permanent modifications. In many instances, we employ "mobile" notaries so customers can sign the documents at a time and place of their choosing to remove some potential confusion and to make sure it is done in sufficient time. We also are placing advertising in major markets with a high density of customers in active trial modifications, encouraging them to be responsive to our attempts to help them sustain homeownership.

We have increased our other customer outreach efforts as well. Since January of this year, Bank of America has participated in more than 215 community outreach events to assist distressed borrowers in 30 states. We also have partnered with three national nonprofits, the National Council of La Raza, the National Urban League, and the National Coalition for the Asian Pacific American Community, in the creation of the Alliance for Stabilizing Communities. We provided funding in support of this national coalition and its work to hold 40 housing rescue fairs over the next two years in 24 communities hardest hit by the foreclosure crisis.

In September, we launched a Bank of America Home Loans Assistance website to provide our customers easy online access to gain answers to their questions about the loan modification process – http://homeloans.bankofamerica.com/homeloanhelp.

Despite these efforts, it is clear that some portion of our 65,000 customers who are facing a December 31 deadline will be unable to complete the process, get the documents signed and notarized and return the required information by the deadline. Having some way to

accommodate these customers within the HAMP program would be helpful, given they were able to achieve substantial compliance with the requirements.

Customers who narrowly miss the deadline will fall into two primary groups:

- Customers that as of December 31, will have all their documentation in and the conversions are set, but they have not signed the final modification document (notary and customer have not met) but will do so shortly after the deadline.
- And, customers that as of December 31, will have all their documentation in, but we are still working with them on issues identified in the underwriting process, and again the final modification documents will be signed shortly after the deadline.

A third group of customers we believe should be considered for special consideration are those who made all of their trial payments but did not make the last payment "timely" as defined by program guidelines, but today are current and all other documentation issues are resolved.

Bank of America is working with Treasury to include these customers within the HAMP program with the same benefits they otherwise would receive. If that is not possible, Bank of America will still attempt to provide these customers with the same affordable payment and modification terms they would have received under HAMP, but through our own programs. The only difference for the customer will be the loss of the annual performance payments the government provides for the first five years.

Overall Success of HAMP

In addition to the focus on permanent conversions, we would like to improve the overall effectiveness of HAMP by offering for consideration areas where the program could be enhanced to help more customers.

Our most recent data provided to Treasury indicates approximately 600,000 customers are potentially eligible for the HAMP program. This population does not include borrowers we have determined do not qualify for HAMP such as where the home is no longer owner occupied

Of those potentially eligible, we have made trial offers to 252,000 customers – nearly half. Of those to whom we have extended offers, 160,000 – or 63% - have started a trial modification by making their first payment. As we continue to pursue all methods of contact, we are hopeful these strong results will improve even further.

As these numbers demonstrate, HAMP has been largely successful in meeting its designed objective, which has been to assist owner-occupied borrowers who have experienced a hardship, or an increase in their loan payment, resulting in an unaffordable monthly housing payment exceeding 31% of their monthly income, and who, with help, can maintain ownership and occupancy of their homes.

However, the program was not designed to assist borrowers who have vacated their home or no longer occupy the home as their principal residence. Nor was the program structured to assist

the unemployed or those who already have a relatively affordable housing payment of less than 31% of their income. Out of our HAMP eligible population, as recently defined by Treasury, of the customers we've talked with, 55% are known to fall into one of these four categories.

These figures represent the depth of the nation's recessionary impacts on homeowners, not the failure of the government program or the efforts of participating mortgage servicers.

Bank of America believes it is necessary to provide solutions to these customer segments that fall outside HAMP's target reach – and we are doing so. We have non-HAMP options we consider to avoid foreclosure including modification programs for non-owners and borrowers with a debt-to-income ratio below 31%, and importantly, forbearance programs for the unemployed.

We also are working with Treasury to expand HAMP to assist in meeting these same challenges - specifically including a program for the unemployed and allowance for a housing ratio less than 31% for low-to-moderate income borrowers.

The benefit of having Treasury take the lead to address these challenges is creating an industry standard that helps all customers and provides investor incentive to help more borrowers qualify. In any case, Bank of America will continue to provide solutions to these customers.

Our goal is to keep as many customers in their homes as possible. We will exhaust every available option, including short sales and deeds in lieu, when a homeowner chooses to sell their property or has no other option except foreclosure. We appreciate Treasury's recently released final guidance on short sales and are pleased to say we have already adopted many of the principles outlined.

Conclusion

At Bank of America, we continue to look critically at the loan modification process, and we are listening to customers, community partners, and other stakeholders about how we can improve. We understand the urgency to offer solutions – not only for the customers we serve – but to further encourage the housing recovery that has begun to take root.

We will continue to pursue transformative initiatives that increase the number of customers receiving assistance, enhance the sustainability of the loans and improve the experience for customers throughout the process.

We appreciate the continued strong support and partnership from the Administration and Congress to reach the goal we all share to help as many of the individuals and families we serve stay in their homes.

Thank you, and I would be happy to answer any questions.

TESTIMONY OF MOLLY SHEEHAN
JPMORGAN CHASE

COMMITTEE ON FINANCIAL SERVICES
United States House of Representatives
December 8, 2009

Chairman Frank, Ranking Member Bachus and Members of the Committee on Financial Services, we appreciate the opportunity to appear before you today on this most important topic of helping homeowners. We recognize that no one benefits from a foreclosure.

My name is Molly Sheehan and I work for the Home Lending Division of JPMorgan Chase as the Executive responsible for Housing Policy. Chase is one of the largest residential mortgage servicers in the United States, serving more than 10 million customers located in every state of the country with mortgage and home equity loans totaling about $1.4 trillion. We are proud to be part of one of this country's pre-eminent financial institutions with a heritage of over 200 years.

Keeping families in their homes

At Chase we are working very hard to help families meet their mortgage obligations and keep them in their homes. On a national level, Chase has been a leader in foreclosure prevention. Since 2007, Chase has continued to expand its comprehensive plan to keep families in their homes, and we have helped prevent over 885,000 foreclosures.

Through November 30, 2009, Chase has offered over 560,000 modifications to struggling homeowners and approved or completed over 112,000 permanent modifications under the Home Affordable Modification Program (HAMP), Chase proprietary modification programs or modification programs offered by the Government Sponsored Enterprises (GSEs).

KEY STATISTICS	HAMP	CHASE*	GSE/FHA/VA	TOTAL
MODIFICATIONS OFFERED	199,033	160,826	208,599	568,458
APPROVED FOR PERMANENT MODIFICATIONS	16,131	72,888	23,182	112,201
PERMANENT MODIFICATION	4,302	58,239	20,808	83,349

* Includes first and second mortgage liens

As reflected in the chart above, Chase uses not only HAMP but also Chase modification programs or other loan modification programs made available by the Government Sponsored Enterprises (GSEs), FHA/VA and private investors. To understand the full range of loan modification activity, these other initiatives need to be counted.

To achieve these results, we have initiated extensive outreach and made significant investments in people, technology and our infrastructure to execute on the commitments we made in announcing our foreclosure prevention plan in October of 2008 and in becoming one of the first participants in HAMP when it was announced by President Obama this past March. In particular, we have:

- Opened 30 Chase Homeownership Centers (CHOCs) in 13 states – 6 more than originally planned – where struggling borrowers around the country can meet face to face with trained counselors, with a planned addition of 21 more sites in the first quarter of 2010
- More than 60,000 borrowers have met with counselors at the centers and the CHOCs have mailed over 538,000 letters to invite Chase customers to discuss their situation with our trained counselors or to help them complete their HAMP documents
- Added over 2,550 loan modification counselors in 2009, bringing the total number to 5,200 loan modification counselors in 15 sites
- Hired 2,825 additional mortgage operations employees to handle the unprecedented volume, bringing the total base to nearly 14,000 Chase Home Lending employees dedicated to helping our customers who are experiencing difficulties with their mortgage
- Handled over 12.8 million inbound calls to our call centers from homeowners seeking foreclosure prevention assistance during the first nine months of 2009, an 84% increase from the third quarter of 2008, including 1.9 million calls to our dedicated customer hotline for modification inquiries through November 2009. Our outbound calls increased to 4 million in 2009, up from 400,000 a year earlier
- Created a dedicated website where borrowers and counselors can go for information about our programs and download the documents needed to apply for a modification. In the last nine months, there have been more than 3.6 million visits to Chase's www.chase.com/myhome website, and borrowers have downloaded 1.6 million modification packages
- Improved our automated tool to pre-qualify borrowers for HAMP which has been rolled out broadly to customer-facing staff, including staff in our Chase Homeownership Centers
- Rolled out MHA training for our staff, non profit counseling partners and borrowers attending HOPE Now outreach events – reaching hundreds of internal and external loan counselors and borrowers
- Increased staff and shifts in our call centers and improved call routing

- Hosted and participated in over 365 homeowner events to educate and inform homeowners about the loan modification process in just the past nine months
- Engaged in strategic outsourcing arrangements to increase customer solicitations and expedite the fulfillment of trial modification packages – over 636,000 letters have been mailed
- Instituted an independent foreclosure review process to avoid preventable foreclosure referrals and sales
- Continued improving customer communication through status letters and dedicated call center staff to respond to status requests
- Established a Program Management Office with dedicated teams to improve our processes, increase management focus, track progress against goals and ensure compliance with MHA Program requirements

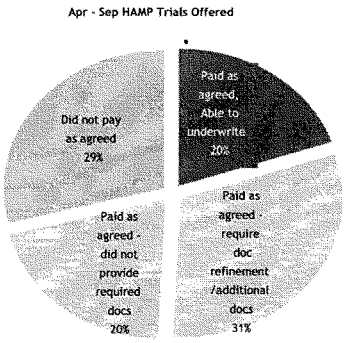
Our Progress in Implementation of the MHA Modification Program

Chase has made significant investments to ramp up our modification capacity since our launch of the HAMP Program on April 6 of this year by hiring people, adding office space and enhancing our technology. We also clearly understand that many more families are anxious about the mortgage on their home and need to hear from us as quickly as possible. Chase is committed to do whatever we can to help homeowners qualify for these programs.

As of November 30, 2009, Chase estimates that it services approximately 479,000 loans potentially eligible under the HAMP guidelines. On a weekly basis, Chase mails letters to borrowers with loans that become 50 days past due and meet basic HAMP eligibility criteria according to information on our servicing databases.

We have made solid progress in offering HAMP trial plans and currently have over 140,000 homeowners in active trial plans through November 2009, and we are now working very hard to convert homeowners to permanent HAMP modifications, but we are facing challenges with borrowers completing documentation or making trial plan payments as agreed.

2009 Year to Date	MHA
Mods offered	199,033
1+ Pays (Active Trials)	140,988
3+ Pays	113,464
Approved for Perm Mod	16,131
Perm Mod completed	4,302



Represents mod vintages where all payments should have been received

As shown by the charts, for every 100 HAMP trial plans initiated from April through September, 2009

- 29 borrowers did not make all required payments under their trial plan, making them ineligible for a permanent modification under HAMP
- 71 borrowers made all three payments under their trial plan. Of those 71,
    - 20 borrowers did not submit all documents required for underwriting
    - 31 customers submitted all required documents but the documents do not meet HAMP underwriting standards which could be due to missing signatures or documents that are not current under the HAMP rules
    - 20 borrowers completed all required documents and are eligible for underwriting.

Based on current underwriting results for the 20 borrowers who gave us all the payments and all the documents correctly,

- 4 borrowers have been or likely will be denied a permanent HAMP loan modification, but may be qualified for other modification programs through Chase or the GSEs
- 16 borrowers are or likely will be approved for a HAMP modification
- Of those 16, 15 have or will likely receive a payment reduction

The focus of our immediate attention is finding ways to assist the 51 borrowers out of 100 that are missing some or all of the documentation required under HAMP or where the documents are incomplete, not current enough or otherwise not acceptable under the HAMP rules. In partnership with the Department of Treasury's Homeownership Preservation Office, Chase is implementing an aggressive series of initiatives to help these homeowners successfully convert into permanent modifications, including:

- Launching a coordinated program to call a customer 36 times, reach out by mail 15 times and make at least two home visits, if necessary, to get the appropriate documents
- Ordering key documents – including property values, tax transcripts, and credit reports -- earlier in the process to expedite underwriting
- Completing the roll-out and training of loan modification counselors on Supplemental Directive 09-07 recently issued by the Department of Treasury that streamlines documentation and underwriting requirements
- Centralizing the review of borrower documentation for accuracy and completeness, easing requirements on loan modification counselors
- Engaging two independent firms to collect missing documentation and official modification agreements from borrowers through in-person visits to their homes
- Deploying outreach efforts specifically for borrowers who live near Chase Home Ownership Centers, so they can come in for in-person support

- Assigned specific pools of accounts to loan modification counselors to provide continuity and end-to-end processing
- Employed additional incentive programs and motivational campaigns to increase productivity across loan modification counselors
- Enhanced document collection and tracking capabilities to increase process efficiency

To help us achieve these goals, we have added hundreds of employees in the last three months that are dedicated to alerting customers and then collecting the documents needed to complete modifications.

We are also focused on how we can accelerate and improve the underwriting process for the 20 out of 100 borrowers who have completed payments and submitted all the required documents but are not getting a permanent modification because of program rules. Some common examples include:

- A borrower includes income from a person or household not on the mortgage note and we are unable to verify the additional income
- The IRS 4506-T Request for Tax Transcript is returned, but the customer did not sign it
- A borrower has difficulty providing supporting documents, such as divorce decrees, death certificates, overtime or bonus information
- A borrower's stated income when the trial modification is begun varies from their documented income at approval time by more than is permitted under the HAMP rules so re-underwriting is required
- A borrower's income obtained from the 2008 tax return cannot be fully reconciled to current documented income as required by the HAMP rules

Recommendations to Improve HAMP Eligibility and Conversion Rates

To further support servicers in transitioning trial plans to permanent modifications, last week the Department of Treasury announced its own series of initiatives, including on site visits with major servicers to address barriers to completion in a real time setting. We applaud the Treasury for this effort. There is no substitute for being in the field and seeing the real challenges facing our employees and our borrowers. Working together this past week and jointly observing the obstacles to success, we can continue to make improvements to the program to enhance its effectiveness, particularly in streamlining documentation. We have included below some recommendations we believe would both increase the population eligible for HAMP as well as improve the ratio of trial modifications that convert to permanent modifications

Re-visit the re-default assumptions in the HAMP NPV Model – Chase believes that the current re-default assumptions are based on historical modification programs that do not have the same rigor as HAMP. As a result, we believe the potential risk of re-default

in the current HAMP model is overstated, negatively impacting the NPV in any given case and resulting in denials that could be avoided. Not only are HAMP modifications based on full underwriting but even more importantly, our data demonstrates that borrowers who are successful in making three payments have significantly better re-performance rates. As a result, we believe that re-default rates will be about 30% to 40% lower than what is implied in the current NPV model. This is crucial because the NPV model can determine whether a modification becomes permanent or gets turned down. So, we recommend that the NPV model be re-evaluated based on the positive impact of key HAMP features such as income verification and trial plan performance. This could improve the number of approved Hamp modifications by up to 25%.

Reduce the Complexity of Income Verification for Salaried Borrowers – HAMP presently requires that servicers obtain an executed IRS form 4506-T from every HAMP applicant and send it to the IRS to receive the most recent tax return for the borrower. Under HAMP rules, we are required to reconcile any differences to the income documentation we have received from the borrower. This requirement has presented several challenges for borrowers and servicers and the 4506-T is the document that is most frequently either not submitted (30% of the time) or not submitted properly completed. While real efforts have been made to improve the process, it is still not clear that the benefits outweigh the additional cost in all cases. We work very hard with our borrowers to reconcile the information on their previous year's tax return to the fully documented current financial information we have obtained, but last year's income is often dated and not comparable to the borrowers current financial situation. If the borrower cannot fully explain the differences, under HAMP, we are forced to decline these borrowers. Chase recommends that for salaried borrowers where W2s and pay stubs are readily available to verify income, servicers should have the option to execute with the IRS form 4506-T only when deemed appropriate. This would significantly reduce the effort involved in reconciling income differences. The 4506-T would still be required to be executed with the IRS in all cases for self employed borrowers where W2s, pay stubs or other forms of income verification are not readily available.

Work with Servicers to Establish a Responsive and Scalable Exception Process – We understand that every borrowers' personal and financial circumstances are highly individual and do not fit neatly into program rules that can appear to be very prescriptive. At the same time, servicers are understandably reluctant to approve exceptions that might appear reasonable but outside the strict parameters of the program rules. Chase recommends that the Department of Treasury support servicer flexibility and discretion by providing a well-staffed help line, as well as continue on site support, to address and approve underwriting exceptions.

Modify Re-trial Requirements when the Borrowers' Income Changes – For delinquent borrowers, Chase approves trial plans based on stated income and then advises the borrower of the documents required to complete the verification process. While the

borrower is making trial payments and providing income verification information, we commonly find that the borrower's income increases or decreases by more than permitted by the HAMP rules. In those cases, we are required to re-evaluate and re-start a new trial period for that borrower based upon the new information, even if the borrower already has successfully completed three trial plan payments. Chase recommends that the number of re-trial payments be reduced to one so borrowers can be provided permanent relief sooner.

Work with Servicers to Allow More Short-Term Modifications and Other Appropriate Flexibility - Chase believes there are opportunities to further enhance HAMP to help borrowers that are not eligible for HAMP under the current Program rules or where their HAMP eligibility has expired and alternative foreclosure prevention solutions can be tailored to address those situations. Chase encourages the Department of Treasury to continue working with servicers and community partners to develop a broad range of solutions for distressed borrowers under the HAMP umbrella. Specifically, Chase recommends that there are three categories of borrower for which new programs should be developed. These include borrowers who have significant other debt obligations, who make trial payments but have not completed the documentation process and who are experiencing shorter term income disruption due to unemployment or unanticipated expenses beyond their control. For these situations, we believe a modification that is similar to HAMP, but is shorter in duration may be the most appropriate approach. Specifically, we recommend a modification that is fixed for two years for those who do not submit the required documentation and fixed for one year when the borrower has other debts that are causing the difficulty in making the mortgage payment.

Our Loan Modification Programs

In October, 2008 we expanded the loan modification alternatives Chase already offered as part of our proprietary Foreclosure Prevention program. The enhanced modification tools allow for more flexibility based on the borrower's current loan type and the borrower's specific financial situation.

Proactive Outreach for ARM borrowers

Chase-owned subprime hybrid Adjustable Rate Mortgages (ARMs) scheduled to reset for the first time are being modified to remain at the initial interest rate for life of the loan. Borrowers qualify for this program if they have a clean payment history on a hybrid ARM with an interest rate that adjusts after the first two or three years. Borrowers do not need to contact Chase to benefit from this program – the rate lock is implemented automatically – and borrowers are so advised.
We use the ASF Fast Track program to reduce payment shock for subprime hybrid ARMs serviced but not owned by Chase and scheduled to reset for the first time. Qualifying borrowers will have their initial ARM rate frozen for five years.

Chase did not originate or purchase Pay Option ARM loans itself but does own and service a portfolio of Pay Option ARM loans as a result of the 2008 acquisitions of the mortgage assets of Washington Mutual from the FDIC and EMC, a subsidiary of Bear Stearns.

To help borrowers with Pay Option ARMs, Chase makes available loan modifications through HAMP and its own proprietary modification programs, as well as through an additional proactive program for Chase owned loans, developed specifically to assist these borrowers. The program is designed to identify in advance and proactively reach out to borrowers with good payment histories that may be at higher risk of default due to a scheduled recast in the next twelve months that could significantly increase their monthly payment. To minimize any potential payment shock, we make the borrower a pre-approved offer to modify their loan to a lower fixed rate loan that keeps their payment at its current amount, which they have already demonstrated the ability to pay. If this payment amount results in a lower than market interest rate, the rate can step up to market over time, subject to certain limits to avoid payment shock. High risk borrowers due to recast in 2009 were mailed proactive outreach offers starting in late 2008 through early 2009 to which over 85% responded. Recently, Chase began mailing pre-approved modification offers to about 1000 borrowers due to recast next year and plans to offer pre-approved modifications to an additional 4000 borrowers by year end.

Under its various programs, Chase has completed modifications of over $6 billion of Pay Option ARMs (14,000 units) through rate reduction, term extension or proactive outreach. In addition to completed modifications, there are customers active in trial modifications under HAMP and Chase modification programs (to the extent they are ineligible under HAMP) that are not yet included in the completed modification figure.

Chase Custom Modifications

Borrowers not eligible for HAMP or any of the systematic Chase modification programs described above are reviewed on a case-by-case basis to determine the suitability of a modification or other foreclosure prevention approach.

Chase custom loan modifications are evaluated by developing an estimated target affordable payment of 31% to 40% of the borrower's gross income. We use the lowest percentage for borrowers with the lowest incomes. Once the target payment is calculated for the borrower, we will test each modification option to see if it will get the borrower to an affordable payment. Concurrently, we apply a net present value (NPV) analysis to each option to determine whether the value of the modification exceeds the value expected through foreclosure. We recommend the modification option that produces both an affordable payment and a positive NPV result. In addition, Chase custom loan modifications offer broader eligibility and payment flexibility compared to HAMP.

Other Foreclosure Prevention Options

Loan modifications are not the only foreclosure prevention technique used by Chase. Chase believes that a refinance into a fully-amortizing FHA- or GSE- insured loan with lower payments may be a better alternative for a number of distressed homeowners. So we offer refinance options for borrowers we believe are at risk of default or may be already delinquent, as well as provide economic incentives (such as principal forgiveness, principal forbearance or rate subsidization) required to refinance these borrowers.

In addition, Chase offers other foreclosure prevention options, such as

- Payment plans (where a borrower agrees to pay back arrearages over time),
- Deferments (where a borrower agrees to make late payments in the future),
- Borrower stipulations (where a borrower agrees to make a set of payments, often as a prelude to a modification), and
- Short-sales / settlements (a form of principal forgiveness where Chase agrees to accept less than the amount of the mortgage in exchange for the underlying property or the proceeds of the sale of the underlying property).

Although borrowers do not keep their homes in short sales and settlements, these may be appropriate solutions when the borrower has no interest in remaining in the home or simply cannot afford the home over the long term, even if payments are reduced by a modification.

Our Community Stabilization Initiatives

Not every foreclosure can be prevented, so it's vital to our communities to look beyond foreclosure prevention in designing strategies to deal with the impact of foreclosed properties on neighborhoods. In 2008, Chase established a dedicated unit under its Homeownership Preservation Office to develop strategies to deal with foreclosed properties, working with our partners in the community and our banking regulators.

As part of our announcement in 2008, Chase committed to donations or discounted sales of 500 foreclosed properties over the next 2-3 years. In just a little over one year, we are more than halfway to our goal. Through November of 2009, we have donated over 69 properties to non profit organizations in 15 states and conducted discounted sales to non profit organizations of over 214 properties in 19 states.

We know that the HAMP program has been difficult for servicers to implement and that has affected our customers' experience. We know that we are accountable to help our borrowers and work to make HAMP a success but we should also remember that a significant amount of progress has been made in a very short period of time. Right now, among all the HAMP participants, over 650,000 borrowers are already benefiting from more affordable monthly mortgage payments through entering into HAMP trial plans and the number continues to grow. We are working very hard to convert trial plans to

permanent modifications and help make HAMP a success. At Chase alone, over 112,000 borrowers have been approved for permanent modifications under HAMP or the other loan modification alternatives we make available to homeowners.

We are pleased to have this opportunity to share our progress with you. We look forward to continuing to work with the members of Congress, the Administration, our federal banking regulators and our community partners in implementing these initiatives to help families, stabilize neighborhoods – and the U.S. economy.

Thank you for your attention and I would be happy to answer any questions you may have.

Respectfully submitted,

Molly Sheehan
SVP, Housing Policy
JPMorgan Chase

HOPE NOW Alliance

Statement for the Record

House Committee on Financial Services

Hearing

"The Private Sector and Government Response To the Mortgage Foreclosure Crisis"

U.S. House of Representatives

December 8, 2009

The HOPE NOW Alliance appreciates the opportunity to submit this statement for the record for the House Financial Services Committee hearing, "The Private Sector and Government Response to the Mortgage Foreclosure Crisis".

The HOPE NOW Alliance ("HOPE NOW") is a broad based industry and non-profit alliance with membership that includes housing counselors, mortgage servicers, investors, and other mortgage market participants. There are currently **46** members of HOPE NOW, including national HUD intermediaries, major mortgage lenders and servicers, Fannie Mae, Freddie Mac, and mortgage industry trade associations. Through unified, coordinated efforts, HOPE NOW members are reaching and helping as many homeowners as possible to maximize the preservation of homeownership and minimize foreclosures.

Many HOPE NOW servicers are participating in the Administration's Home Affordable Modification Program ("HAMP"), and the Alliance itself has worked consistently with our partners like the GSEs and the Administration in implementing and improving the HAMP program. HOPE NOW and its members are working to implement HAMP as effectively as possible as it is an important tool to prevent foreclosures.

HOPE NOW servicers continue to make dramatic on-going progress in reaching and helping borrowers. In addition to HAMP modifications, HOPE NOW servicers provide other modification and workout solutions for homeowners in difficulty who do not qualify for HAMP. HOPE NOW and its partners are continuing outreach events for borrowers to receive face-to-face assistance from servicers and counselors, and we have a special project to develop a web portal for counselors and servicers to streamline the submission of homeowner HAMP applications.

HAMP

HOPE NOW and its members are supporters of and participants in the Administration's HAMP program. The HAMP program is an important part of an overall effort to help at-risk homeowners avoid foreclosure and stay in their homes. The fact that servicers initiated more than **650,000** HAMP trial modifications by November 1 and extended almost 920,000 trial mod offers by that date shows that there has been a significant effort made to utilize HAMP to prevent foreclosures and assist homeowners. This means that 650,000 troubled homeowners are making a smaller, more affordable mortgage payment each month.

We fully recognize that the focus now is to turn these trial modifications into permanent modifications. Mortgage servicers participating in the Administration's HAMP program are doing everything possible to reach homeowners currently in a trial modification and complete the packages to enable them to get a permanent modification.

To help increase the number of people that are assisted under the HAMP program and increase the number of trial modifications that become permanent modifications, servicers have made a number of suggestions to Treasury to strengthen the program and enhance its implementation. These suggestions are included later in this statement.

Loan Workouts

In addition to HAMP, the mortgage industry continues to make significant efforts to help homeowners avoid foreclosure. One of the largest cooperative efforts is through the HOPE NOW Alliance. The latest data collected by HOPE NOW on workout solutions for homeowners shows that in 2009, 2.6 million homeowners received a mortgage workout that prevented a foreclosure. Overall, the industry has helped nearly 5.8 million homeowners avoid foreclosure since HOPE NOW started tracking workout data in mid-2007.

In addition to HAMP modifications, lenders and servicers are helping homeowners through a variety of plans including proprietary bank/investor specific loan modifications, repayment plans, extended forbearance, as well as deed in lieu, and short sales. The industry is continuing to produce individualized workout solutions tailored to each borrower's unique situation.

Outreach

Another critical task that HOPE NOW servicers, non-profits and other partners have focused on is contacting and helping borrowers in-person. Since 2008, HOPE NOW has held 55 outreach events in key housing markets, providing opportunities for homeowners to meet in-person with a housing counselor and/or their mortgage servicer.

Mortgage servicers, municipal government agencies, Federal Reserve Banks, numerous regulators including the Department of the Treasury, housing counseling agencies, local foreclosure prevention task forces and other partners have come together at various locations across the country to help nearly 50,000 borrowers. HOPE NOW is currently planning approximately 30 outreach events across the country for 2010, and is working closely with Treasury and the HAMP program in all these events.

All HOPE NOW mortgage servicers participate in a monthly direct mail campaign to make sure delinquent borrowers are aware of their options for assistance. Over 250,000 HOPE NOW outreach letters are mailed to delinquent borrowers every single month. Since November 2007, HOPE NOW servicers have mailed over 5.7 million letters to at-risk homeowners, achieving an 18% response rate, which is approximately 6 times higher than typical servicer-to-borrower mailings.

In addition, HOPE NOW continues to support and promote the Homeownership Preservation Foundation's Homeowner's Hope™ Hotline, 888-995-HOPE. The Hotline provides FREE counseling to homeowners, and is available 24 hours a day, 7 days a week, and 365 days a year. Since October of 2007, the Hotline has received over 3.2 million calls and counseled over 730,000 homeowners. The Hotline averages more than 5,500 calls per day, and in the past few weeks that number has risen to 8,000 calls per day.

Web Tools

To better assist homeowners avoid foreclosure and receive a loan modification, the HOPE NOW Alliance has developed a variety of web tools for homeowners and housing counselors. Since late 2007, HOPE NOW's website, www.hopenow.com, is a useful resource for homeowners and housing counselors, containing information about how to reach mortgage servicers, what documentation is needed, and education about the different types of loan workouts. Additionally, a borrower can complete an online self assessment to determine if they meet the basic criteria to qualify for HAMP and provide detailed financial information that can immediately be sent to servicers to begin the process to obtain a workout solution.

To further assist at-risk homeowners, HOPE NOW has launched a web portal, "HOPE LoanPort", with six housing counselor agencies, six nationwide servicers, and a mortgage insurer who serves as a sponsor. This web portal allows HUD-approved housing counseling agencies to assist troubled homeowners by submitting a homeowner's full application for assistance for a loan modification under the HAMP program. Through the HOPE LoanPort, counselors can submit all the homeowners' financial data and necessary documentations through secure lines directly to servicers. Housing counselors are able to track the progress of a homeowner's HAMP loan application. This program will help streamline the process of documenting and verifying where a delinquent

borrower is in the process of qualifying for a HAMP modification by directly providing servicers with a completed application package. This web portal will also assist in converting HAMP trial modifications to permanent modifications. The expectation of the HOPE LoanPort is better communication between servicers, counselors, and homeowners, including elimination of lost documentation issues. The objective is to scale this to market, gain broad adoption, and work with strategic partners to leverage LoanPort.

In 2010, the HOPE LoanPort will be expanded to include several servicer and counselor participants by leveraging a neutral open architecture for information to be imported and exported to existing case management systems. This neutral portal will also provide market transparency to identifying where any challenges may exist in the system. The development of this portal was based on significant feedback from investors, servicers, and non profit counseling organizations who all have a vested interest in its success. We will continue to report on the progress the LoanPort achieves in enabling servicers and counselors to assist more homeowners with their loan modification applications.

Improvements to HAMP

The HAMP program is an important addition to the effort to help at-risk homeowners who want to stay in their homes and have an ability to do so with some assistance. However, it does have some significant flaws that can be addressed to convert more homeowners from trial modifications to permanent ones. Here are several important changes that servicers have suggested to the Treasury Department. A number of these suggestions were developed by the HOPE NOW servicer working group. A complete list has been provided to the Treasury Department.

1) **Streamline HAMP documentation**. The HAMP program has detailed documentation requirements for both homeowners and servicers. Some of these are necessary to maintain the integrity of the program, but others can be adjusted to enable to servicers to identify and process qualified homeowners more quickly. One significant change that should be made is to immediately adjust documentation requirements to streamline income verification for wage earners. Many homeowners in a trial modification are not completing the tax return requirement. ***Treasury should consider eliminating the requirement for tax returns for wage earners and allow use of most recent W-2 or two most recent pay stubs.*** This change could significantly advance modifications and underwriting timelines. Some servicers estimate an increase of 20-30% in modification conversions. An alternative could be some form of ***"implied approval" process where the homeowner is notified that if they make the trial payment they are authorizing the lender to request their tax return information.***

Non-wage earner homeowners should continue to provide tax returns to verify income.

2) **Revise the re-default assumptions in the HAMP NPV Model.** The Net Present Value Model (NPV) should be updated to reflect the positive impact of key HAMP features such as trial plan performance and income verification. The current re-default assumptions are based on historical modification programs that do not have the same rigor as HAMP and are resulting in homeowners not qualifying for the program. HAMP modifications are based on full underwriting, and servicer data demonstrates that borrowers who are successful in completing a three month trial plan prior to permanent modification have significantly better re-performance rates. With this change, some servicers estimate that re-default rates will be about 30 to 50% lower than what is implied in the current NPV model.

3) **HAMP modification expirations**: A clear policy is needed for borrowers in HAMP trial modifications who (1) are current on their payments but fail to provide documents required by HAMP for a permanent modification; (2) are current but provided documents after the required time frame; or (3) made three payments but outside the required time period. If a homeowner is paying at the modified rate, policies should be established to deal with them rather than move to foreclosure. Servicers and the Administration should discuss options to set a uniform approach prior to December 31, 2009.

4) **Establish responsive and scalable exception process.** Treasury should establish a well-staffed help line and on site support for servicers to review and approve underwriting exceptions. Borrowers' personal and financial circumstances are highly individual and do not fit neatly into program rules that are quite prescriptive. Servicers are understandably reluctant to approve exceptions that are reasonable but outside the strict parameters of the program rules. Rapid response from Treasury would help these homeowners receive assistance.

5) **Clear communication and training for homeowners, counselors, servicers and advocates on HAMP process.** The Administration should increase clear and simple communications to consumers, counselors, servicers and investors on HAMP requirements, The Administration should strengthen efforts to clarify who is eligible for HAMP. There continues to be confusion among homeowners and stress on servicers in determining HAMP eligibility.

6) **HOPE NOW LoanPort:** The LoanPort initiated by HOPE NOW has the potential to assist counselors and servicers to help more borrowers complete their applications in at timely manner. Treasury should work with HOPE NOW members to scale use of LoanPort in order to enable housing counselors to assist borrowers in submitting complete applications for HAMP modifications. It will

help address a critical concern- ***no more lost documents and incomplete applications between counselors and servicers.***

7) **HOPE NOW outreach events**: The Administration, HOPE NOW and other partners also can help more homeowners by holding events dedicated to collecting HAMP documentation from homeowner on existing trial modifications in high risk areas, and Treasury can assist servicers and counselors in a program to locate in key high risk markets for one to two months to make substantial impact on assisting homeowners in those areas.

These are a number of steps that can be taken to strengthen the HAMP program; others should be reviewed after the current drive to convert trial modifications is completed. Serviers tell us that no new program requirements should be made until these changes are in place.

Unemployment

Unemployment continues to be the greatest challenge complicating loan modification efforts. An unemployed homeowner can often not pay ANY debts. Even a HAMP loan modification cannot work if the homeowner has lost his or her income. Serious evaluation should be made on a product for unemployed borrowers. While under HAMP unemployed borrowers with extended benefits may be eligible for a modification, many unemployed homeowners will not pass the NPV test. Creating an investor and industry acceptable solution that assists homeowners who have a willingness and desire to stay in their homes while looking for re-employment is a high priority.

Recognize Other Efforts to Assist Homeowners

Mr. Chairman, the HAMP program is an important effort that is assisting hundreds of thousands of homeowners. At the same time, servicers continue to assist hundreds of thousands more homeowners who do not qualify for HAMP through other solutions. These homeowners are avoiding foreclosure. HOPE NOW data shows that in 2009, 2.6 million troubled homeowners have received workouts that have prevented foreclosures. Going forward we would like to work with the Administration on how HOPE NOW can report on non-HAMP modifications and workouts that are effectively assisting homeowners and preventing foreclosures.

Mr. Chairman, Ranking Member Bachus and members of the Committee, the servicers, counselors and other partners in the HOPE NOW Alliance are dedicated to implementing HAMP providing outreach and other assistance to troubled homeowners. These efforts will continue into 2010 until the housing market stabilizes and homeowners in need have received needed assistance. Thank you for the opportunity to provide this statement

Questions from Representative John Adler (D-NJ)

1) **Why have Chase and Bank of America not signed up for Treasury's "2MP" (second lien program)?**

   Chase and Bank of America have signed up for Treasury's second lien program (2MP). Wells Fargo and Citigroup have also joined 2MP. These four servicers comprise half of the market for second liens. In the next thirty days, we expect to develop a database platform that will allow servicers to match second liens to first liens modified under HAMP. By alerting second lien holders that the first is modified, this new system facilitates the process of modifying second liens more quickly.

2) **How is it remotely appropriate to modify 1st lien mortgages, yet not force 2nd lien mortgage holders (which would be worth almost nothing if the 1st were to foreclose) to share the cost of restructuring the borrower's housing debt?**

   We agree that it is important that second lien mortgage holders share the cost of restructuring the homeowner's housing debt. We believe that 2MP will make an important difference in standardizing this cost-sharing relationship.

3) **Do you think that the success rate of HAMP modifications would be greater if 2nd lien holders shared the sacrifice of 1st lien holders, benefiting both 1st lien investors and homeowners?**

   Yes, we agree that the success rate of HAMP modifications would be greater if second lien holders shared the costs of loan modifications. We developed 2MP to provide a framework for both lien holders to modify mortgages concurrently, enabling a fairer cost-sharing arrangement and providing greater affordability for home owners.

4) **Do you think there is a conflict of interest inherent in the fact that the four largest money-center banks own over $430B in second liens on their books yet are modifying hundreds of thousands of 1st liens that they do not own?**

   Treasury has now signed agreements with four of the largest banks, whose second lien holdings comprise half the market for second liens. Participation in 2MP helps to ensure that these large servicers modify not only the first lien mortgages they service, but also the second liens they hold in their portfolio. These four companies will receive the information they need to modify second liens where they service the first lien, and they will be able to modify all corresponding second liens once the matching database platform is operational.

Questions from Representative Joe Baca (D-CA)

1) **Some evidence on the progress of the HAMP programs shows that some people aren't even able to take advantage of the program because they simply cannot get their paperwork in order, or they aren't aware of how to access the program.**

   I have seen recently that Freddie Mac is now piloting a program that uses in-person contact to inform homeowners on the HAMP process and assisting them with the paperwork. I am also aware that it is common practice for banks to do this for their own loans when homeowners are distressed, shelling out the extra cost to try to save their investment.

   Could you comment on the role of in-person contact and counseling within the HAMP program, and ways to expand its use? It seems to me that doing something like this could only help troubled homeowners.

   We recognize that many borrowers have had trouble collecting the appropriate paperwork to achieve a permanent modification. In response to these obstacles and in order to raise the level of awareness of the program's benefits, Treasury embarked on a nationwide campaign with the goal of helping borrowers with trial modifications convert to permanent modifications. As I stated in my prepared remarks, the conversion drive was a multi-pronged approach built on targeted outreach efforts where we brought borrowers and servicers together to work on solutions offered through the Making Home Affordable program.

   Recognizing that personal contact may help promote mortgage modifications by assisting borrowers with their questions and applications, Treasury built capabilities into the Homeowner's HOPE Hotline, a free service for borrowers which can be reached by calling 1-888-995-HOPE. At any time of day, borrowers can speak with a HUD-approved counselor directly and receive information to assist them in applying for a HAMP modification. If a borrower should require further help with a HAMP specific problem, he or she can ask to speak with MHA Help after calling the HOPE Hotline. The borrower will be automatically directed to a dedicated team of HAMP housing counselors who are able to explain program requirements and determine if servicers have followed program rules.

   We know that in-person contact provides both borrowers and lenders with an opportunity to discuss solutions face-to-face. As you point out, Freddie Mac is not alone in using in-person contact to reach out to borrowers about the HAMP. A number of servicers recognize that this approach can be used to better connect with their borrowers.

   We have also been working closely with Fannie Mae to hold a number of foreclosure prevention workshops and borrower outreach events in cities facing high foreclosure rates. At these events, borrowers have the opportunity to meet face-to-face with their

servicer, discuss MHA solutions, and submit the required documents to apply for the program. Our foreclosure prevention events also include counselor training forums where representatives from Treasury, Fannie Mae, HUD and other agencies provide information and training to local housing counselors and non-profit groups, leveraging local resources to expand the reach of the HAMP program.

Additionally, we have been working to support servicers with the information they need to promote the program, which includes holding regular meetings to share best practices and encourage more aggressive outreach to potentially eligible homeowners. Meetings coordinated by HOPE NOW have also provided a platform where servicers and housing advocates share strategies and commit to utilizing those practices to reach struggling borrowers. One of the key products of this partnership has been the development of the HOPE LoanPort, a web portal which will allow housing counselors to help borrowers collect the necessary HAMP documents, upload the completed package directly to servicers and track the status of a borrower's application. The loan portal was launched on December 10, 2009 and expanded to over 100 key markets on February 24, 2010.

Lastly, with the recent issuance of Supplemental Directive 10-02: *Borrower Outreach and Communication*, we are holding servicers accountable for more proactive outreach efforts by defining reasonable, clear, and measurable procedures for soliciting borrowers who are potentially eligible for HAMP. Servicers must not make a foreclosure referral until a borrower has been evaluated for HAMP and determined ineligible or if the aforementioned reasonable solicitation efforts have failed. Servicers must also document all contacts attempts in a borrower's servicing file in order to provide an account of their outreach efforts. Servicers will be deemed to have made a reasonable effort to solicit a borrower if their record of outreach efforts meets standard benchmarks set forth by Treasury in this guidance.

Responses to Additional Questions from Representatives Adler and Baca
Relating to the December 8, 2009 Hearing before the
U.S. House of Representatives Committee on Financial Services
Julia Gordon, Center for Responsible Lending
January 29, 2010

Adler

1) **Why have Chase and Bank of American not signed up for Treasury's 2MP (second lien) program?** Not applicable.

2) **How is it remotely appropriate to modify 1st lien mortgages, yet not force 2nd lien mortgage holders (which would be worth almost nothing if the 1st were to foreclose) to share the cost of restructuring the borrower's housing debt?** While modifying first liens is clearly very helpful for many homeowners, modifying or extinguishing second liens would likely lead to more sustainable modifications for a few reasons: overall monthly housing payments would be reduced; overall homeowner debt would be reduced; and, perhaps most important, principal reduction would be more likely.

3) **Do you think that the success rate of HAMP modifications would be greater if 2nd lien holders shared the sacrifice of 1st lien holders, benefiting both 1st lien investors and homeowners?** Please see answer to #2.

4) **Do you think there is a conflict of interest inherent in the fact that the four largest money-center banks own over $430B in second liens on their books yet are modifying hundreds of thousands of 1st liens that they do not own?** There is a conflict of interest for servicers owned by the large banks related to principal reduction. The problem is that first lien owners are unlikely to permit a principal reduction on the first lien unless the second lien is extinguished or at least reduced, but the banks (who hold the second liens) have been unwilling to write down second liens. Therefore, the servicers face a conflict of whether to act in the best interest of their clients (the investors in the first lien) or the banks.

Baca

Some evidence on the progress of the HAMP program shows that some people aren't even able to take advantage of the program because they simply cannot get their paperwork in order, or they aren't aware of how to access the program.

I have seen recently that Freddie Mac is now piloting a program that uses in-person contact to inform homeowners on the HAMP process and assisting them with the paperwork. I am also aware that is common practice for banks to do this for their own loans when homeowners are distressed, shelling out the extra cost to try to save their own investment.

Could anyone comment on the role of in-person contact and counseling within the HAMP program, and ways to expand its use? It seems to me that doing something like this could only help troubled homeowners.

In our experience, troubled homeowners have much better outcomes when they are assisted by knowledgeable intermediaries such as housing counselors or attorneys. We also have seen good results from mandatory mediation programs where servicers and homeowners are able to meet face-to-face. We agree that the system overall is likely to work better with more assistance from such intermediaries and with more opportunities for personal, face-to-face contact, and we welcome any additional resources that can help make such contact more likely. However, we believe homeowners are best helped by intermediaries who do not have a financial stake in the outcome of the negotiations.

Response to questions from
the Honorable John Adler
by the Federal Deposit Insurance Corporation

Q1. Why have Chase and BOA not signed up for Treasury's "2MP" (second lien) program?

A1. The FDIC cannot speculate as to why Chase and BOA have not signed up for 2MP. As program administrator, Treasury is managing these institutions' 2MP applications and would have insight on this matter.

Q2. How is it remotely appropriate to modify 1st lien mortgages, yet not force 2nd lien mortgage holders (which would be worth almost nothing if the 1st were to foreclose) to share the cost of restructuring the borrower's housing debt?

A2. Simultaneous modification of both the first and second liens on a homeowner's house would achieve the best results for the homeowner and the most equitable resolution of the troubled mortgage for the lienholders. Unfortunately, it has proven difficult in many cases to achieve a modification of both liens, which may be held by different investors, usually in different securitization transactions, and may not both be delinquent. We agree that the modification of a second lien, as well as the carrying value of that lien, should reflect its reduced value and collectability when the borrower is delinquent on the first lien or the home has a negative equity. If the second lienholders carry the loan at its more accurate, written-down value, this will likely promote more active modifications by second lienholders.

Nonetheless, when faced with a delinquency on the first lien, a priority must be placed on remedying this immediate delinquency if it is possible to avoid a more costly foreclosure. For this reason, the FDIC's loan modification program, as well as HAMP, focuses on avoiding foreclosure where it would be more costly than a modification even if the second lien cannot be modified. Borrowers in default on first lien debt are on a fixed timeline moving towards foreclosure. The longer a borrower remains delinquent on the mortgage the more past due interest and escrow accrue to the borrower's account making it more difficult to restructure the loan and return the borrower to performing status. It is important that the first lien servicer takes a proactive approach in evaluating the borrower for modification so as to minimize the loss to investors and to reach out to distressed borrowers with appropriate loss mitigation options.

Q3. Do you think that the success rate of HAMP modifications would be greater if 2nd lien holders shared the sacrifice of 1st lien holders, benefiting both 1st lien investors and homeowners?

A3. Yes, modifications for homeowners with multiple liens would be more successful if all lien holders granted concessions. Unfortunately, given complications with negotiations between lien holders, dual modification may not be available and, where it is, it is often difficult and time consuming.

Q4. Do you think there is conflict of interest inherent in the fact that the four largest money-center banks own over $430 B in second liens on their books yet are modifying hundreds of thousands of 1st liens that they do not own?

A4. Assuming this statement is true, there is an inherent, potential conflict of interest. Nonetheless, servicers can address these conflicts with an effective separation of responsibilities and liabilities. Servicers are contractually required to pursue the least costly loss mitigation options for the investor in each securitization and risk legal liability if they do not apply prudent servicing practices. However, there is no question that many securitization market participants have questioned whether these potential conflicts are being effectively addressed.

Response to question from
the Honorable Joe Baca
by the Federal Deposit Insurance Corporation

Q1. I would like to ask this question to the entire panel. Some evidence on the progress of the HAMP program shows that some people aren't even able to take advantage of the program because they simply cannot get their paperwork in order, or they aren't aware of how to access the program.

I have seen recently that Freddie Mac is now piloting a program that uses in-person contact to inform homeowners on the HAMP process and assisting them with the paperwork. I am also aware that is common practice for banks to do this for their own loans when homeowners are distressed, shelling out the extra cost to try to save their investment.

Could anyone comment on the role of in-person contact and counseling within the HAMP program, and ways to expand its use? It seems to me that doing something like this could only help troubled homeowners.

A1. The FDIC strongly supports the integration of counseling and community groups in the loan modification process. Delinquent borrowers are often inundated by various collection calls and may be reluctant to respond to inquiries from the loan servicer, even if the inquiry relates to loan modification. Non-profit counseling or community groups are a valuable third party resource that may be able to more easily contact the borrower and provide guidance through the modification process. While implementing the loan modification program at Indymac Federal Bank, the FDIC established ties with local and national community groups. Contracts were signed with a number of non-profit groups. These groups received $500 for each borrower that they helped through the modification process. This is a win-win for servicers struggling to manage high volumes of distressed borrowers and for investors since debt counseling helps borrowers manage finances and improve their ability to continue making loan payments.

Questions from Rep. Adler

1. Why have Chase and Bank of America not signed up for Treasury's "2MP" (second lien) program?

National banks and servicers have a number of programs in place to work with troubled borrowers, and the government-sponsored HAMP and 2MP (second lien) programs are additional alternatives available to them. We understand that Bank of America, Wells Fargo, JP Morgan Chase and Citi recently have signed up for Treasury's 2MP program.

2. How is it remotely appropriate to modify 1st lien mortgages, yet not force 2nd lien mortgage holders (which would be worth almost nothing if the 1st were to foreclose) to share the cost of restructuring the borrower's housing debt?

HAMP's primary objectives are foreclosure prevention and to keep borrowers in their homes. Loan modifications targeted to first lien loans have the greatest impact on reducing a borrower's total debt burden and achieving sustainable monthly payments. Because of the relative difference in size between first lien and second lien loans, modification of the first lien mortgage generally results in a much greater reduction in the borrower's total monthly debt burden than a modification of the second lien. While a borrower's total debt, including second lien loans, is an important consideration, loan modifications for first lien mortgages are the primary means of preventing avoidable foreclosures.

Still, the OCC has encouraged servicers to work with borrowers facing difficulties in making payments on any of their residential real estate loans, whether a first lien or a subordinate lien mortgage, and to provide appropriate home retention actions whenever possible. At times, the borrower may be current on the payments of the second lien loan yet seriously delinquent on the first lien mortgage loan, in which case the servicer might not be aware that the borrower is distressed. While it is often difficult for servicers to obtain the information needed to effectively restructure and modify multiple residential real estate loans to the same borrower, particularly when one of the loans is current or the loans are held or serviced by different entities, various initiatives are underway to make this information more readily available and to enable more effective modification actions.

Current second lien loans that stand behind delinquent or modified first lien loans have an elevated risk of default and loss. Consistent with OCC guidance, examiners are instructed to have banks appropriately reflect the credit risk though higher loan loss reserves when they become aware that the first lien has been modified

3. Do you think that the success rate of HAMP modifications would be greater if 2nd lien holders shared the sacrifice of 1st lien holders, benefiting both 1st lien investors and homeowners?

Because we are still in the early stages of HAMP modification efforts, there are no well-defined success measures in place. However, the premise of HAMP is to structure loan modifications in a manner that achieves sustainable mortgage payments over time. As stated above, because of the relative difference in size between first lien and second lien loans, modification of the first lien mortgage generally results in a much greater reduction in the borrower's total monthly debt burden than a modification of the second lien. Available data, including information published in the OCC/OTS Mortgage Metrics Reports, show that the amount of reduction in the mortgage payment is directly correlated to sustainable performance after a modification.

4. Do you think there is a conflict of interest inherent in the fact that the four largest money-center banks own over $430 B in second liens on their books yet are modifying hundreds of thousands of 1st liens that they do not own?

On August 6, 2009, the financial regulatory agencies issued a joint statement to all federally regulated financial institutions on "*Support for Responsible Loss Mitigation Activities.*" This statement reiterates the FFIEC members' continued support for responsible loss mitigation activities designed to preserve homeownership. This support extends to programs designed to achieve sustainable mortgage obligations regardless of lien position. The Agencies recognize that entities servicing first and subordinate liens on the same residential real estate property may be faced with potential conflicts of interest when making loan modification decisions. A servicer's decision to modify the first lien mortgage should not be influenced by the potential impact of the modification on the subordinate lien loan and vice versa. Any ownership interest in the subordinate lien cannot be a consideration. Consequently, servicers were reminded of the following:

- Servicers have an obligation to act in the best interests of the owners/investors of serviced residential mortgage loans and in accordance with the terms of the governing contracts. Any decisions that are not anticipated to produce a greater recovery to investors given the alternatives may constitute a breach of that duty.

- Regardless of any potential effect on the subordinate lien obligations, servicers should modify the first lien mortgage when doing so would produce a greater anticipated recovery to the first lien owners/investors than not modifying the loan. Failure to do so may be a breach of the servicer's obligation to those owners/investors.

- Similarly, regardless of any potential effect on the first lien mortgage, servicers should modify the subordinate lien loan when doing so would produce a greater anticipated recovery to the subordinate lien owners/investors than not modifying the loans. Failure to do so may be a breach of the servicer's obligation to those owners/investors.

Question from Rep. Baca

Some evidence on the progress of the HAMP program shows that some people aren't even able to take advantage of the program because they simply cannot get their paperwork in order, or they aren't aware of how to access the program. I have seen recently that Freddie Mac is now piloting a program that uses in-person contact to inform homeowners on the HAMP process and assisting them with the paperwork. I am also aware that it is common practice for banks to do this for their own loans when homeowners are distressed, shelling out the extra cost to try to save their investment. Could you comment on the role of in-person contact and counseling within the HAMP program, and ways to expand its use? It seems to me that doing something like this could only help troubled homeowners.

Servicers report that in-person contact is a critical success factor in loan modification programs. Similarly, informed counseling by appropriately trained loan counselors has proven very beneficial in helping borrowers through the modification process. OCC has supported such efforts to develop in-person contact with borrowers through its support of the Hope Now Alliance as well as in its capacity as a Board agency at NeighborWorks America.

The Hope Now Alliance conducts outreach events to provide face-to-face counseling for delinquent borrowers with the goal of developing loan workout solutions whenever possible. In 2009, 31 outreach events took place, reaching 31,000 homeowners to help them receive in-person assistance with their mortgage situation. For 2010, there are 28 more of these outreach events that have taken place or are being planned.

OCC has been a strong advocate of NeighborWorks America's National Foreclosure Counseling Mitigation (NFMC) program, which provides financial and technical support to local agencies that provide foreclosure counseling. The NFMC has received a total of $475 million in appropriated funds over the past three years and the Administration has requested $113 million for NFMC for FY 2011. The NFMC program has reported that 92 percent of the NFMC grantees offer the option of face-to-face counseling for their clients. Of the 762,284 clients that have been served by NFMC grantees as of November 2009, approximately 44 percent have taken advantage of the option of receiving in-person counseling. An evaluation of the NFMC program conducted by the Urban Institute in 2009 found that homeowners counseled during the first year of the program were 1.6 times more likely to avoid or get out of foreclosure than those who did not receive NFMC counseling.

OCC has also developed publications that highlight best practices in foreclosure prevention that are designed to help bankers provide effective loan modification services. OCC has published an Insights Report, *Foreclosure Prevention: Improving Contact with Borrowers* at http://www.occ.treas.gov/cdd/Foreclosure_Prevention_Insights.pdf and a newsletter, *Homeownership: Preserving the American Dream*, which can be found at http://www.occ.treas.gov/cdd/cd_spring06.pdf . Both of these reports highlight best practices in providing in-person, face-to-face foreclosure counseling.

Questions to Chase Home Lending, JPMorgan Chase

From

The U.S. House of Representatives Committee on Financial Services

Hearing on

"The Private Sector and Government Response to the Mortgage Foreclosure Crisis"

Held on December 8, 2009

Responses submitted January 29, 2010

Question from Representative Joe Baca

I would like to ask the entire panel. Some evidence in the progress of the HAMP program shows that some people aren't even able to take advantage of the program because they simply cannot get their paperwork in order, or they aren't aware of how to access the program.

I have seen recently that Freddie Mac is now piloting a program that uses in-person contact to inform homeowners on the HAMP process and assisting them with the paperwork. I am also aware that [it] is [a] common practice for banks to do this for their own loans when homeowners are distressed, shelling out the extra cost to try to save their investment.

Could anyone comment on the role of in-person counseling within the HAMP program and ways to expand its use? It seems to me that doing something like this could only help troubled homeowners.

> Chase understands that homeowners facing financial stress managing their mortgages often can benefit from special attention and "hands-on" focusing on their particular situation. Chase recognized this value early in the current crisis and in October 2008, Chase launched an industry leading effort to open a national network of Chase Homeownership Centers (CHOCs) to personally assist borrowers in those communities most affected by the current crisis.
>
> We believe that Chase is unique in the industry in its focus on access and service by establishing these grass roots offices to work with borrowers to help prevent foreclosures. To help better address particular local needs and circumstances, CHOC locations are chosen with the goal of serving borrowers face-to-face, partnering with local housing counselors to amplify our reach, and helping to tailor events and invitations around the borrowers that live within a reasonable distance of each CHOC.
>
> The CHOCs are a crucial component of our extensive outreach and partnership efforts with national and local not-for-profit housing counselors. They are one component among the many significant investments in people, technology and infrastructure summarized in our

December 8, 2009, testimony. The CHOCs enable Chase to better execute on the commitments we made in announcing our foreclosure prevention plan in October of 2008 and in becoming one of the first participants in HAMP when it was announced by President Obama this past March.

In 2009, Chase opened 34 CHOCs in 13 states – 10 more than originally planned – where borrowers can meet face to face with trained counselors. We plan to add 17 more sites in the first quarter of 2010 for a total of 51 CHOCs in 15 states. In 2009, more than 60,000 borrowers met with counselors at the centers and the CHOCs have mailed over 538,000 letters to invite Chase customers to discuss their situation with our counselors or to help them complete their HAMP documents.

Opening CHOCs across the country reflects Chase's commitment to helping families stay in their homes whenever possible. Struggling homeowners can visit a CHOC to meet face-to-face with a trained loan advisor to discuss their situation and get access to on-the-spot temporary relief while they gather the documents required to convert trial modifications into permanent modifications.

Focusing exclusively on helping our borrowers avoid foreclosure, the specially trained advisors start by trying to gain a complete understanding of the distressed family's financial situation. These advisors help borrowers determine whether they qualify for a HAMP modification, a Chase modification or another program that could help the borrower preserve homeownership. If a borrower appears likely to qualify for a HAMP loan modification, the loan advisor can approve the start of an appropriate trial plan and put the borrower on a path to convert the trial modification into a permanent one.

For example, in California, we currently have 9 CHOCs open and operating to help our California homeowners. They are located in San Diego, Santa Ana, Glendale, Downey, Rancho Cucamonga, Oakland, Sacramento, Stockton and Santa Clara. The CHOC located in Glendale opened its doors on December 28, 2008, and was the first CHOC opened by Chase. To date, of the over 60,000 borrowers that have met with loan counselors at the CHOCs nationwide, nearly 29,000 of those were interactions with homeowners in California. In 2009, Chase participated in 134 outreach events in California, 36 of them sponsored by the California CHOCs. Collectively, we were able to assist over 6300 borrowers through these events.

Chase is committed to continue to focus its efforts in California in the communities most in need. On February 15, we expect to open the first of 7 additional CHOCs in California in Crenshaw. By the end of the first quarter of 2010, we expect to add 6 more sites in San Diego, Los Angeles, and Walnut Creek, for a total of 16 CHOCs in California. In addition to adding more CHOCs, we are also adding staff to our existing CHOC locations in California to allow us to serve more customers.

Since 2008, Chase has maintained a dedicated website where borrowers and counselors can go for updated information about our home preservation programs and download the documents needed to apply for a mortgage loan modification. In the last nine months, there have been more than 3.6 million visits to Chase's www.chase.com/myhome website, and borrowers have downloaded 1.6 million modification packages.

Most recently, in 2009, Chase provided free management resources to Hope Now and leading national counseling agencies to implement enhancements to the existing hopenow.com web portal. Participating housing counselors and servicers now have access to improved tools to manage HAMP loan modification requests. With Chase technical assistance, Hope Now was able to expand its existing website to provide robust and secure tools for the collection and transmittal of completed applications and documentation relating to HAMP loan modification requests, including offering periodic status reports to in-process modifications. Launched in November 2009 as a neutral functional utility, Hope Now's LoanPort helps counselors to better serve borrowers by providing uniform intake protocols to screen borrowers for HAMP eligibility, document collection and transmittal tools, and periodic status reports for their loan work out requests.

Questions from Congressman Adler (4)

1. Why have Chase and Bank of America not signed for Treasury's "2MP" (second lien) program?

   In mid-2009, the Treasury Department put on hold its proposed second lien program ("2MP") while it worked with other government agencies, including the Office of the Comptroller of the Currency, Chase's primary regulator, and mortgage servicers to refine its earlier proposal. Chase has been an active participant in the discussions. On January 26, 2010, Treasury released a revised draft supplemental directive for 2MP. Chase is presently reviewing the draft for comments and will now be able to better understand the implications and requirements of the program.

2. How is it remotely appropriate to modify 1st lien mortgages, yet not force 2nd lien mortgage holders (which would be worth almost nothing if the 1st were to foreclose) to share the cost of restructuring the borrower's housing debt?

   Both first and second lien mortgage holders generally retain certain rights to collect on deficiencies from borrowers if the proceeds from the real estate are not sufficient to repay the unpaid principal balance of the mortgage loans. The Treasury Department's initial 2MP proposal recognized that the rights of second lien holders are not worthless. A workable 2MP framework needs to recognize and fairly value the release or modification of the rights of second lien holders. We applaud Treasury's efforts to fairly address the complex issues presented by second liens in a fair and realistic way and to provide for a fair and orderly resolution process.

3. Do you think that the success rate of HAMP modifications would be greater if 2nd lien holders shared the sacrifice of 1st lien holders, benefiting both the 1st lien investors and homeowners?

   Chase has been an active participant in discussions with Treasury and other agencies to adopt a protocol to address second mortgage liens. We believe that the adoption of a 2MP framework could contribute to improve the success of HAMP and we applaud the Treasury Department for further improvement to the program.

4. Do you think there is a conflict of interest inherent in the fact that the four largest money-center banks own over $430 B in second liens on their books yet are modifying hundreds of thousands of 1st liens that they do not own?

   Not when the modification and servicing efforts are conducted, as Chase does, in accordance with the applicable contractual requirements and industry standards and practices. Chase services loans owned by third parties in the same manner in which it services its own portfolio, giving due consideration to customary and usual standards of practice. Industry practice values loan modifications for their contribution to preventing avoidable foreclosures and maximizing value to mortgage investors. Loan modifications are consistent with prevailing industry loss mitigation best practices and satisfy important market and public policy expectations. By modifying first mortgages, mitigating defaults and preventing avoidable foreclosures, servicers can help keep more families in their homes, help stabilize communities and contribute to the economic recovery of the nation.

Respectfully submitted,

Molly Sheehan

○